



THE INSTITUTE OF
**CHARTERED
ACCOUNTANTS**
OF NEPAL

VALUATION MANUAL, 2083

Satdobato, Lalitpur
2083 Ashad

VALUATION MANUAL, 2083

(APPROVED BY 369TH COUNCIL MEETING HELD ON 2083/03/20)



The Institute of Chartered Accountants of Nepal
Satdobato, Lalitpur

2083 Ashad

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Preface

Valuation has become a cornerstone of modern business decision-making in Nepal. Whether it is for financial reporting, M&A, restructuring, tax compliance, or investment analysis, the market relies heavily on credible, well-supported valuation conclusions. As transactions grow more complex, the demand for consistency, technical rigor, and unwavering professional standards has never been more urgent.



In response to this need, the Institute of Chartered Accountants of Nepal (ICAN) has developed the Valuation Manual, 2083. This document is designed as a practical, hands-on reference for Chartered Accountants and valuation practitioners across the country. Our goal is to promote transparency and uniformity in practice by aligning fundamental valuation concepts, methods, and real-world challenges with Nepal's specific legal and regulatory framework.

It is important to note that this Manual is not a rigid rulebook, nor does it replace professional intuition. It is meant to guide practitioners in exercising sound judgment across diverse scenarios. Users must read this text alongside current statutory laws, regulatory directives, and ethical standards, adapting the guidance to the unique facts of each case.

I extend my sincere gratitude to CA Anand Raj Sharma Wagle, Vice President, the Council and the Standard Implementation Review Committee of ICAN chaired by CA Peeyush Anand and CA Sachet Lal Shrestha, Consultant for developing this Manual, for their guidance and inputs in reviewing this Manual. I also thank everyone who contributed their valuable insights during its finalization. Finally, I acknowledge the significant efforts of the ICAN management team, led by CA Bimal Dangol, Executive Director, for their active involvement in bringing this Manual to its final shape. I trust that this Manual will become an indispensable tool for members, regulators, financial institutions, and students alike. Ultimately, we hope it raises the benchmark for quality and credibility across the entire valuation profession in Nepal.

We welcome your feedback and suggestions to help us refine and improve future editions.

A handwritten signature in black ink, appearing to read 'Nil Bahadur Saru Magar'.

.....
CA Nil Bahadur Saru Magar
President, ICAN

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List of Abbreviation

ANAV	Adjusted Net Asset Value
ARR	Accounting Rate of Return
ASB	Accounting Standards Board
BSM	Black-Scholes Model
BV	Book Value
CAC	Contributory Asset Charges
CAGR	Compound Annual Growth Rate
CapEx	Capital Expenditures
CAPM	Capital Asset Pricing Model
CCA	Comparable Company Analysis
CCMM	Comparable Companies Multiple Method
CGU	Cash-Generating Unit
COGS	Cost of Goods Sold
D/E	Debt to Equity Ratio
DCF	Discounted Cash Flow
DIO	Days Inventory Outstanding
DLOC	Discount for Lack of Control
DLOM	Discount for Lack of Marketability
DOI	Department of Industries
DPO	Days Payable Outstanding
DRC	Depreciated Replacement Cost
DRHP	Draft Red Herring Prospectus
DSO	Days Sales Outstanding
DSRA	Debt Service Reserve Account
EBIT	Earnings Before Interest and Taxes
EBITDA	Earnings Before Interest, Taxes, Depreciation, and Amortization
EEM	Excess Earnings Method
EPS	Earnings Per Share
ERC	Electricity Regulatory Commission
ERP	Equity Risk Premium
ESOP	Employee Stock Option Plan
EV	Enterprise Value
FCA	Fellow Chartered Accountant
FCF	Free Cash Flow
FCFE	Free Cash Flow to Equity holders
FCFF	Free Cash Flow to Firm
FDI	Foreign Direct Investment
FMCG	Fast-Moving Consumer Goods
FVTPL	Fair Value Through Profit or Loss
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GDP	Gross Domestic Product

GRI	Global Reporting Initiatives
IBN	Investment Board Nepal
ICAN	Institute of Chartered Accountants of Nepal
IESBA	International Ethics Standards Board for Accountants
IFRS	International Financial Reporting Standards
IP	Intellectual Property
IPO	Initial Public Offering
IRD	Inland Revenue Department
IRR	Internal Rate of Return
IVS	International Valuation Standards
IVSC	International Valuation Standards Council
LTM	Last Twelve Months
M&A	Mergers & Acquisitions
MPEEM	Multi-Period Excess Earnings Method
MRR	Monthly Recurring Revenue
NAS	Nepal Accounting Standards
NAV	Net Asset Value
NEPSE	Nepal Stock Exchange
NFRS	Nepal Financial Reporting Standards
NIA	Nepal Insurance Authority
NOI	Net Operating Income
NOPAT	Net Operating Profit After Tax
NPR	Nepalese Rupee
NRB	Nepal Rastra Bank
NRV	Net Realizable Value
NWC	Net Working Capital
OCR	Office of Company Registrar
P/E	Price to Earning
PE/VC	Private Equity Venture Capital
PPA	Purchase Price Allocation
PTA	Precedent Transactions Analysis
PV	Present Value
RCN	Replacement Cost New
RFR	Relief From Royalty
ROIC	Return on Invested Capital
SASB	Sustainability Accounting Standards Board
SEBON	Securities Board of Nepal
SME	Small and Medium Enterprise
SOTP	Sum of The Parts
SPV	Special Purpose Vehicle
TV	Terminal Value
VC	Venture Capital
VWAP	Volume-Weighted Average Price
WACC	Weighted Average Cost of Capital
WWM	With-and-Without Method
YTM	Yield to Maturity

Introduction to Valuation

1.1 Background to the Valuation Manual

In the evolving economic environment of Nepal, valuation has emerged as an essential professional service supporting informed economic decisions by businesses, investors, regulators, and other stakeholders. Recognizing the growing need for reliable, objective, and transparent valuation practices, the Institute of Chartered Accountants of Nepal (ICAN) has developed this Manual.

The Manual is designed to provide a structured and consistent approach for professional accountants undertaking valuation engagements, thereby enhancing the credibility and comparability of valuation reports issued by members of the Institute. By establishing a common framework, this Manual aims to bridge existing practice gaps and foster professional excellence in valuation services.

1.2 Introduction to Valuation

Valuation refers to the process of determining the economic value of an asset, business, liability, or financial interest at a specific point in time, based on relevant information, assumptions, and appropriate valuation methodologies. The objective of valuation is to provide an independent and reasoned estimate of value that can support informed decision-making by users of the valuation.

Valuation plays a critical role in a wide range of financial and commercial activities, including business acquisitions, financial reporting, taxation, investment analysis, restructuring, dispute resolution, and regulatory compliance. The valuation process typically involves the application of professional judgment, analytical techniques, and recognized valuation approaches to assess the value of the subject matter under consideration.

Professional valuation requires consideration of multiple factors, including the nature of the asset or business being valued, the purpose of the valuation, the availability and reliability of information, prevailing market conditions, and appropriate valuation methodologies such as the income approach, market approach, and asset-based approach.

Accordingly, the practice of valuation demands a disciplined and transparent framework to ensure that the conclusions reached are reasonable, supportable, and capable of withstanding professional scrutiny.

1.3 Purpose and Objective of the Valuation Manual

1.3.1 Purpose

The primary purpose of this Valuation Manual is to establish a uniform and professionally sound framework for Chartered Accountants and other qualified members of the Institute of Chartered Accountants of Nepal (ICAN) engaged in valuation assignments. The Manual seeks to ensure that all valuation reports issued by members are:

- Technically robust and compliant with relevant standards, including Nepal Financial Reporting Standards (NFRS), Nepal Accounting Standards (NAS), and International Valuation Standards (IVS), as adopted or referred to in Nepal;

- Ethically sound, aligned with the ICAN Code of Ethics and professional independence requirements;
- Transparent, consistent, and reliable for use by stakeholders such as regulators, investors, lenders, auditors, courts, and tax authorities.

This Manual is issued by ICAN in response to the growing demand for valuations across various sectors, including corporate restructuring, mergers and acquisitions, financial reporting, litigation, insolvency, and regulatory compliance. It is intended to enhance the credibility of valuation opinions issued by Professional Accountants and to foster trust among users of such valuations.

1.3.2 Objectives

The specific objectives of this Valuation Manual are:

- To standardize the principles, approaches, and reporting formats used in valuation exercises conducted by ICAN members.
- To ensure valuation practices are in conformity with applicable regulatory frameworks, such as accounting standards (NFRS/NAS) and regulatory requirements from bodies such as SEBON, NRB, NIA, OCR, IRD, DOI, Electricity Regulatory Commission (ERC), Investment Board Nepal (IBN)
- To guide members in exercising due professional care, judgment, and competence in planning, performing, and reviewing valuation engagements.
- To bring clarity and consistency to valuation methodologies such as the Income Approach, Market Approach, and Asset-Based Approach, and in applying necessary adjustments or normalizations.
- To define best practices in documenting valuation procedures, working papers, and justifications for assumptions, thereby enabling transparency and auditability.
- To enhance the credibility of valuation reports, ensuring stakeholders including companies, regulators, and courts have confidence in the work performed by ICAN members.
- To provide real-world examples, case scenarios, and templates to assist professionals in applying the concepts effectively in practice.

By doing so, this Manual aspires to elevate the quality of valuation practice and strengthen public trust in the professional work performed by members of the Institute.

1.4 Prospects for Professional Accountants

Given this evolving landscape, valuation services present a significant opportunity for professional accountants to:

- Extend their service offerings into specialized valuation advisory, beyond traditional audit and tax;
- Support corporate clients, banks, investors, and regulatory filings through credible, standardized valuation reports;
- Contribute to strengthening Nepal's capital markets, FDI environment, and financial reporting ecosystem by providing independent and objective valuations.

By aligning practice with the principles outlined in this Manual, professional accountants can not only comply with regulatory requirements but also position themselves as trusted valuation experts in a growing and dynamic field.

1.5 Scope and Applicability

1.5.1 Scope

This Manual on valuation sets out the principles, methodologies, and reporting expectations to be followed by members of the Institute of Chartered Accountants of Nepal (ICAN) when undertaking or reviewing valuation engagements. It provides a standardized approach that incorporates applicable accounting, legal, regulatory, and ethical requirements within the Nepalese context.

The scope of this Manual includes, but is not limited to, valuation assignments involving:

- a. **Business and Equity Valuation:** For mergers, acquisitions, capital restructuring, shareholder transactions, or strategic investments.
- b. **Fair Value Measurement:** As required under NFRS 13 and other applicable standards for financial reporting.
- c. **Valuation of Tangible and Intangible Assets:** Including land and buildings, plant and machinery, trademarks, patents, goodwill, and customer relationships.
- d. **Valuation of Financial Instruments:** Such as equity shares, preference shares, debentures, convertible instruments, and complex securities.
- e. **Regulatory and Legal Purposes:** Including those required by:
 - » Securities Board of Nepal (SEBON)
 - » Nepal Rastra Bank (NRB)
 - » Nepal Insurance Authority (NIA)
 - » Inland Revenue Department (IRD)
 - » Office of the Company Registrar (OCR)
- f. **Valuation in Insolvency and Litigation:** Including valuation in the context of liquidation, insolvency proceedings, and dispute resolution.
- g. **Valuation for Internal Purposes:** Such as strategic planning, investment decisions, and management decision support.
- h. **Foreign Direct Investment (FDI):** Determining fair value for repatriation purposes on the sale of shares of unlisted companies by foreign investors, as required by regulatory authorities.

This Manual is applicable regardless of the form or purpose of the valuation assignment whether for financial reporting, transaction advisory, taxation, compliance, or legal support. This Manual seeks to provide practical guidance and standardization for valuation engagements across these diverse contexts, ensuring that the resulting valuation reports are professionally robust, consistent, and credible.

1.5.2 Applicability

This Manual shall be applicable to the following categories of ICAN members:

- a. **Practicing Member:** Members in public practice who provide valuation services to clients as part of their professional engagements.
- b. **Members in Industry:** Members engaged as internal valuers, finance managers, or in other roles where they undertake valuation activities for their employer.
- c. **Valuation Reviewers and Assurance Providers:** Members who review valuation reports in the course of audit, assurance, or due diligence assignments.

Additionally, this Manual shall be applicable when members:

- Issue valuation certificates or reports, whether stand-alone or as part of another engagement;
- Use valuation outcomes to support or justify financial reporting under NFRS/NAS;
- Are involved in engagements where fair value or valuation inputs are relied upon in regulatory filings or tax submissions.

It is recommended that members refer to this Manual in conjunction with applicable laws, accounting standards, and regulatory directives. In case of conflict, the provisions of the applicable law or regulation shall prevail.

1.6 Key Definitions and Terminologies

- a. **Adjusted Book Value:** The net asset value of a company after adjusting the book value of assets and liabilities to their fair market values.
- b. **Asset-Based Approach:** A valuation method that estimates the value of an entity based on fair value of its net assets.
- c. **Capitalization Rate:** The rate used to convert an income stream into value by dividing the expected earnings by this rate.
- d. **Comparable Company Analysis (CCA):** A market-based valuation method that derives value using valuation multiples of similar listed companies.
- e. **Control Premium:** An amount a buyer is willing to pay over the market price to acquire a controlling interest in a company.
- f. **Discounted Cash Flow (DCF):** An income-based valuation approach that discounts forecasted cash flows to present value using an appropriate discount rate.
- g. **Fair Value:** The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.
- h. **Going Concern:** An accounting assumption that the entity will continue operating in the foreseeable future.
- i. **Intended User(s):** The individual(s), entity(ies), or stakeholder(s) who are expected to rely on the valuation report. These may include company management, regulators (e.g., NRB,

SEBON, NIA, OCR, DOI), auditors, investors, tax authorities, or courts of law. The valuer should clearly identify and communicate with the intended users in the valuation report and engagement letter.

- j. **Marketability Discount:** A reduction in the value of a security to reflect its illiquidity or difficulty in being sold in the market.
- k. **Minority Discount:** A discount applied to reflect the lack of control in a shareholding.
- l. **Net Asset Value (NAV):** The value of an entity's assets minus its liabilities, often used in asset heavy businesses.
- m. **Option Pricing Models:** Mathematical models such as Black-Scholes or Binomial used to estimate the value of options and other contingent securities.
- n. **Precedent Transactions Analysis:** A valuation method that uses multiples derived from past transactions involving similar companies.
- o. **Professional Accountants:** Chartered Accountants and other qualified members of the Institute of Chartered Accountants of Nepal (ICAN).
- p. **Terminal Value:** The value of a business beyond the explicit forecast period, often calculated using the perpetuity growth model.
- q. **Valuation Engagement:** A professional engagement undertaken by a qualified member to determine the value of an asset, business, security, or liability in accordance with a defined scope, purpose, and basis of value. The engagement may be for financial reporting, transaction, compliance, dispute resolution, or internal decision-making.
- r. **Valuation Date:** The specific date as of which the value is determined. It reflects the economic conditions and market circumstances prevailing on that date. The valuation date may differ from the reporting date or the date of the engagement.
- s. **Valuer:** A Chartered Accountant or other qualified professional engaged to perform a valuation assignment in accordance with this Manual, applicable professional and technical standards, and the relevant regulatory framework. The terms "valuer" and "professional accountant" are used interchangeably throughout this Manual to refer to the individual responsible for the valuation engagement.

1.7 Regulatory and Legal Framework

1.7.1 Overview

Valuation assignments undertaken by members of the Institute of Chartered Accountants of Nepal (ICAN) must be performed within the bounds of the prevailing legal and regulatory framework in Nepal. This section outlines the key statutes, regulatory bodies, and professional standards that influence valuation practices and reporting. Understanding this framework is essential to ensure legal compliance, professional accountability, and public confidence in the valuation outputs.

1.7.2 Key Legal and Regulatory Sources

Professional accountants undertaking valuation assignments in Nepal must be well-acquainted with the

applicable legal and regulatory framework that governs valuation activities across various sectors and use cases. Awareness and compliance with these provisions are critical to ensure that the valuation output is credible, defensible, and suitable for its intended purpose. Key legal and regulatory sources include:

- a. **Companies Act, 2063 (2006):** Provides legal provisions for share valuation in cases such as mergers, acquisitions, issue of new shares, or restructuring. It also governs the requirement for independent valuations during amalgamations and arrangements.
- b. **Income Tax Act, 2058 (2002):** Prescribes valuation requirements in the context of capital gains taxation, related party transactions, transfer pricing, and asset transfers, especially for assets transferred without consideration or between related parties.
- c. **Nepal Financial Reporting Standards (NFRS):** Issued by ICAN, these include standards such as NFRS 13 (Fair Value Measurement), NFRS 3 (Business Combinations), NAS 36 (Impairment of Assets) and NFRS 9 (Financial Instruments), which require or guide fair valuation of assets, liabilities, or equity interests for financial reporting.
- d. **Unified Directives of Regulatory Bodies:**
 - Nepal Rastra Bank (NRB): Mandates valuations for mergers of banks and financial institutions, classification of collateral assets, and provisioning requirements.
 - Nepal Insurance Authority (NIA): Requires fair value disclosures and valuations under NFRS 17 for insurance contract liabilities and investments.
 - Securities Board of Nepal (SEBON): Prescribes valuation methods and disclosure requirements for IPO pricing, rights issues, ESOPs, and delisting of securities.
- e. **Inland Revenue Department (IRD):** Provides administrative guidance related to tax compliance, including valuation methodologies for income tax purposes.
- f. **Judicial Precedents and Case Laws:** Valuation engagements linked to litigation or dispute resolution may be subject to interpretations established by court judgments. Professional accountants must stay updated on relevant rulings that may influence valuation approaches, especially in shareholder disputes or inheritance matters.
- g. **International Frameworks and Standards:** In addition to national laws, reference may be made to globally recognized valuation principles such as the International Valuation Standards (IVS) issued by the International Valuation Standards Council (IVSC), especially when required by foreign investors, cross-border transactions, or multinational engagements.

Professional accountants should remain vigilant to updates in legal, tax, accounting, and regulatory frameworks and ensure that each valuation assignment adheres to the specific compliance requirements applicable to nature, industry, and purpose of the valuation.

1.7.3 Accounting and Financial Reporting Standards

Valuations performed for financial reporting purposes must comply with relevant Nepal Financial Reporting Standards (NFRS) and Nepal Accounting Standards (NAS) issued by the Accounting Standards Board (ASB). Key applicable standards include:

Standards	Title / Area
NFRS 13	Fair Value Measurement
NAS 38	Intangible Assets
NAS 2	Inventories
NFRS 9	Financial Instruments
NAS 16	Property, Plant & Equipment
NAS 36	Impairment of Assets
NAS 40	Investment Property
NFRS 3	Business Combinations
NAS 12	Income Taxes (Deferred tax on revalued assets)

In all such cases, the valuer must ensure:

- Application of the highest and best use principle (NFRS 13)
- Use of observable market inputs wherever available
- Appropriate classification within the fair value hierarchy (Level 1, 2, or 3)

1.7.4 Professional and Ethical Framework

The Manual complements but does not override the requirements of:

- Nepal Financial Reporting Standards (NFRSs) issued by Accounting Standards Board (ASB) Nepal;
- Code of Ethics for Professional Accountants issued by ICAN (aligned with IESBA Code);
- Valuation standards issued by other regulatory authorities, where specific valuation formats or methodologies are prescribed.
- International Valuation Standards (IVS), which may be used as reference unless inconsistent with local laws and standards.

In case of a conflict between this Manual and a specific regulatory requirement, the latter shall prevail. Members are encouraged to document such deviations and provide appropriate justifications in their valuation reports.

1.7.5 Enforcement and Disciplinary Oversight

Failure to comply with the legal and professional framework may result in:

- Regulatory penalties by bodies such as SEBON, NRB, NIA, IRD, or OCR.
- Disciplinary actions by ICAN for professional misconduct or negligence.
- Legal liabilities arising from misstatements, omissions, or fraudulent valuation practices.

Members are advised to maintain adequate documentation, demonstrate application of professional judgment, and disclose all relevant assumptions and limitations in their valuation reports to mitigate legal and reputational risks.

1.8 Challenges in Valuation

Data limitations: Lack of audited financials, incomplete disclosures, and no active secondary markets for private assets.

Market information gaps: Scarcity of recent transaction data and valuation benchmarks, limiting use of market-based methods.

Uncertain assumptions: Forecasts depend on macroeconomic volatility, regulatory changes, and company-specific risks.

Subjectivity and professional judgment: Heavy reliance on estimates and management inputs due to limited data and lack of uniform guidance.

Valuation inputs: Difficulty determining discount rates or WACC in the absence of robust local bond markets and equity risk premium data.

Inconsistent disclosures: Varying practices among comparable companies reduce reliability and comparability.

1.9 Basis of Valuation and Premises

The basis of value represents the fundamental measurement premise used in a valuation and defines the nature of the value being estimated. It reflects the assumptions regarding the participants in the transaction and the circumstances under which the valuation is performed.

Common bases of value include, but are not limited to:

- **Market Value** – the estimated amount for which an asset or liability should exchange between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where both parties act knowledgeably, prudently, and without compulsion.
- **Fair Value** – the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, as defined under applicable financial reporting standards.
- **Investment Value** – the value of an asset to a particular investor based on individual investment requirements and expectations.
- **Liquidation Value** – the amount that may be realized from the sale of assets when a business is wound up or assets are sold under specific conditions.

The selection of an appropriate basis of value depends on the purpose of the valuation, regulatory requirements, and the intended use of the valuation report.

The premise of value refers to the assumed set of circumstances under which the asset or business is valued. It reflects the operational context in which the asset is expected to generate economic benefits. It includes:

- **Going Concern Premise** – assumes that the business will continue to operate in the foreseeable future and generate ongoing economic benefits.
- **Orderly Liquidation Premise** – assumes that assets will be sold individually over a reasonable period of time.

- Forced Liquidation Premise – assumes assets must be sold immediately, often resulting in lower realized values.
- Assembled Asset Premise – assumes assets are used together as part of a functioning business operation.

The premise of value significantly influences the selection of valuation approaches, assumptions, and modeling techniques.

1.10 Identification of the Subject of Valuation

Before performing a valuation, it is essential to clearly identify what is being valued. The subject of valuation may include:

- Business enterprises or equity interests
- Tangible assets such as property, plant, and equipment
- Intangible assets including intellectual property, goodwill, and brand value
- Financial instruments or investments
- Specific contractual rights or liabilities

Clear identification of the subject of valuation ensures that the valuation scope, assumptions, and methodologies are appropriately applied.

1.11 Valuation Engagement and Valuation Review

Professional accountants may be involved in valuation assignments in different capacities. It is important to distinguish between a valuation engagement and a valuation review.

Valuation Engagement

A valuation engagement involves performing a full valuation analysis and arriving at an independent estimate of value. In such engagements, the professional accountant is responsible for:

- defining the scope of the valuation,
- selecting appropriate valuation approaches and methods,
- gathering and analyzing relevant data,
- developing valuation models and assumptions, and
- issuing a valuation report expressing a valuation conclusion.

Valuation engagements are commonly undertaken for purposes such as mergers and acquisitions, financial reporting, tax compliance, restructuring, regulatory submissions, and investment decisions.

Valuation Review

A valuation review involves evaluating the work performed by another valuer or by management to assess the reasonableness and appropriateness of the valuation methodology, assumptions, and conclusions.

Valuation reviews may be performed in situations such as:

- audit and assurance engagements,
- financial reporting oversight,

- regulatory review, or
- independent assessment of third-party valuation reports.

In a valuation review, the professional accountant does not necessarily perform a complete valuation but instead evaluates whether the valuation performed by others is reasonable and compliant with applicable standards.

1.12 Role of a Professional Accountant in Valuation

Professional accountants, as members of the Institute of Chartered Accountants of Nepal (ICAN), are uniquely positioned to undertake valuation engagements due to their technical competence, ethical grounding, and understanding of financial, legal, and regulatory frameworks. This section outlines the multifaceted roles they are expected to fulfill in the course of valuation assignments.

- Financial Expert with Technical Competence:** Professional Accountants are equipped to analyze financial data, assess business performance, and apply appropriate valuation methodologies. Their knowledge of accounting standards and financial modeling enables accurate and credible valuations.
- Independent and Objective Professional:** ICAN members must act independently and avoid conflicts of interest. Their role is to provide unbiased, evidence-based valuation opinions that reflect fair market value.
- Support in Strategic and Regulatory Decisions:** Valuations performed by Professional Accountants are used in mergers, acquisitions, share transfers, tax filings, financial reporting, and regulatory approvals. Their work supports key decisions by management, boards, investors, and regulators.
- Reviewer of Valuation Reports:** In audit and assurance roles, Professional Accountants evaluate the appropriateness of valuation methodologies and assumptions used by management or external valuers, ensuring compliance with NFRS and regulatory requirements.
- Documentation and Compliance:** They are responsible for maintaining adequate documentation of valuation work, including data sources, assumptions, and calculations. This supports transparency, auditability, and adherence to ICAN's quality standards.
- Contributor to Professional Standards:** Through practice, training, and capacity building, Professional Accountants help promote consistency, ethics, and professionalism in the field of valuation.

Scope of Work and Engagement Letter

2.1 Scope of Work

Prior to undertaking a valuation engagement, the valuer shall clearly define the scope of work for the assignment. Defining the scope of work at the outset helps ensure that both the valuer and the client have a common understanding regarding the purpose, extent, and limitations of the valuation engagement. It also establishes the parameters within which the valuation will be conducted and reported.

The scope of work should generally include the following elements:

- Identification of the client and intended users of the valuation report.
- Purpose of the valuation, such as financial reporting, transaction support, regulatory compliance, taxation, dispute resolution, or internal decision-making.
- Identification of the asset, liability, or business interest that is the subject of valuation.
- Valuation date and reporting date, where applicable.
- Basis or bases of value to be adopted (e.g., fair value, market value, investment value).
- Valuation approaches and methods expected to be applied where relevant.
- Nature and extent of information to be provided by the client or obtained from other sources.
- Key assumptions, special assumptions, and limiting conditions, if any.
- Expected form and content of the valuation report.

Clearly defining the scope of work enhances transparency in the valuation process and helps ensure that the valuation is performed in a manner consistent with professional standards and the intended purpose of the engagement.

2.2 Engagement Letter

Before commencing the valuation assignment, the valuer should formalize the terms of engagement with the client through a written engagement letter or agreement. The engagement letter serves as a formal record of the understanding between the valuer and the client regarding the scope, responsibilities, and terms governing the valuation engagement.

The engagement letter should normally include the following matters:

- Identification of the client and the valuer.
- Description of the valuation assignment and scope of work.
- Purpose of the valuation and intended use of the valuation report.
- Responsibilities of the client and the valuer, including provision of relevant information.
- Valuation date and expected reporting timeline.

- Professional fees and billing arrangements.
- Confidentiality obligations.
- Independence and conflict of interest considerations, where applicable.
- Limitations on the use or reliance of the valuation report.

Documenting these terms helps prevent misunderstandings, promotes transparency in professional engagements, and ensures that valuation assignments are undertaken with appropriate clarity regarding expectations and responsibilities.

Professional and Ethical Considerations in Valuation

Professional accountants performing valuation services are expected to uphold the highest standards of integrity, objectivity, and professional competence. Since valuation involves significant professional judgment, ethical conduct and adherence to the Code of Ethics issued by the Institute of Chartered Accountants of Nepal (ICAN), aligned with international standards, are central to maintaining public confidence and professional credibility.

This chapter outlines the key ethical and professional principles that must guide valuation engagements.

3.1 Ethical Responsibilities under the Code of Ethics

Valuation engagements require a high degree of professional judgment. Professional Accountants must adhere to the ethical principles outlined in the ICAN Code of Ethics, which is aligned with the International Code of Ethics for Professional Accountants (IESBA Code). The following fundamental principles are especially critical in the context of valuation:

- a. Integrity:** A Professional Accountants must be straightforward and honest in all professional and business relationships. Valuation reports must reflect genuine analysis, not influenced by pressure from clients or stakeholders. Misrepresentation or selective disclosure of facts is a breach of professional conduct.
- b. Objectivity:** Members must avoid bias, conflicts of interest, or undue influence when performing valuation work. The valuer's role is not to justify a predetermined value but to independently determine value based on facts and professional judgment.
- c. Professional Competence and Due Care:** Professional Accountants must undertake valuation assignments only when they possess the necessary knowledge, skills, and experience. They are expected to apply professional diligence throughout the valuation process and stay updated with developments in standards, laws, and market practices.
- d. Confidentiality:** Information acquired during a valuation engagement must not be disclosed without proper authority or used for personal advantage. Valuers must ensure that sensitive data such as financials, assumptions, and business plans is protected and only shared with authorized parties.
- e. Professional Behavior:** Members must comply with relevant laws and avoid actions that discredit the profession. Any attempt to inflate or deflate valuations to serve client interests, regulatory arbitrage, or avoid taxes undermines public trust and may result in disciplinary action.

Valuation engagements often involve sensitive financial data, strategic business plans, and judgments that can influence stakeholder decisions. Hence, professional accountants must apply ethical principles rigorously at each stage of the valuation process.

3.2 Independence, Objectivity, and Conflict of Interest

Independence is critical where the valuation report is intended for external stakeholders, such as regulators, tax authorities, courts, or investors. A professional accountant should:

- Avoid situations where their financial or other interests may impair objectivity.
- Disclose any existing or potential conflict of interest in writing.
- Decline engagements where independence cannot be reasonably maintained.

In engagements involving related parties, recurring clients, or internal reporting, the accountant must document safeguards applied to preserve objectivity. A transparent and well-communicated declaration of independence enhances the credibility of the valuation report.

3.3 Confidentiality and Data Protection

Professional accountants must maintain strict confidentiality over all client information obtained during the course of a valuation engagement. Such information should not be disclosed to third parties without proper authority or legal obligation, nor used for personal gain. Members are expected to handle both physical and digital data securely, limit access to authorized personnel, and ensure compliance with applicable data protection laws. Any intended reliance on the valuation by third parties must be clearly disclosed, and appropriate client consent should be obtained where required.

3.4 Due Diligence and Professional Competence

Valuation requires careful analysis, technical expertise, and informed judgment. Professional accountants must:

- Possess adequate knowledge of the industry, subject assets, and valuation methodologies relevant to the assignment.
- Evaluate all available financial and non-financial information with professional skepticism.
- Apply appropriate valuation approaches in line with the purpose and regulatory context of the engagement.

Where the required competence lies outside the accountant's area of expertise (e.g., actuarial assumptions, engineering assessments), the use of qualified specialists is advised, with the accountant retaining responsibility for the final conclusion.

3.5 Use of Specialists

In certain valuation engagements, a professional accountant may require input from individuals possessing technical or domain-specific expertise beyond the conventional scope of accounting and finance. This becomes particularly relevant in complex valuation assignments where the nature of the asset, industry, or underlying assumptions necessitates specialized knowledge or professional judgment in other disciplines. The engagement of such specialists is essential to ensure the reliability, defensibility, and professional quality of the valuation conclusion. Specialists may include, but are not limited to:

- Actuaries, for the valuation of insurance liabilities, pension obligations, and structured financial products.
- Engineers, for evaluating the physical condition, productivity, or replacement cost of infrastructure, industrial assets, or machinery.
- Real estate valuers, for determining the fair market value of land, buildings, or other immovable property.
- Legal experts, for interpreting contractual rights, ownership structures, or regulatory frameworks.
- IT professionals, for valuation of proprietary technology, software assets, or digital infrastructure.
- Industry consultants, for market intelligence, pricing assessments, and forecast validation in specialized sectors.

While the specialist provides technical input or expert opinion within their area of competence, the professional accountant remains ultimately responsible for the overall valuation opinion and must critically evaluate the relevance and appropriateness of such inputs. Responsibilities of the professional accountant include:

- Assessing the qualifications, experience, and independence of the specialist
- Ensuring the specialist's scope of work aligns with the valuation objective and standards
- Integrating the expert input appropriately within the selected valuation approach
- Disclosing reliance on specialists clearly in the final valuation report

All interactions with the specialist, including the engagement scope, deliverables, findings, and reliance rationale, should be properly documented and retained in the valuation working papers.

3.6 Data and Inputs

The valuer shall identify, assess, and appropriately use the data and inputs necessary to support the valuation analysis. The reliability and relevance of the valuation conclusion depend significantly on the quality, completeness, and appropriateness of the data used.

Data and inputs used in a valuation engagement may include both financial and non-financial information obtained from internal and external sources. These may include historical financial statements, management forecasts, market transaction data, economic indicators, industry benchmarks, asset registers, legal documents, and other relevant information.

The valuer should exercise professional judgment in assessing the reliability, relevance, and sufficiency of the information obtained. Where information is provided by the client or third parties, the valuer should consider whether the information appears reasonable and consistent with other available evidence. If significant limitations or uncertainties exist in the data used, such limitations should be appropriately disclosed in the valuation report.

Data and inputs used in the valuation process may generally be categorized as follows:

- Entity-specific data, including historical financial information, budgets, forecasts, operational data, and asset records.



- Market-based inputs, such as market prices, comparable transaction data, industry multiples, and prevailing market conditions.
- Macroeconomic and industry data, including economic indicators, regulatory developments, and sector-specific trends.
- Valuation assumptions and parameters, such as discount rates, growth rates, risk adjustments, and other key valuation inputs.

Professional accountants performing valuation engagements should ensure that the data and inputs used are relevant to the valuation purpose, consistent with the selected valuation approach, and adequately documented. Where appropriate, the valuer should also disclose the sources of data, key assumptions made, and any limitations associated with the information used.

Proper documentation and transparency regarding the data and inputs used in the valuation process enhance the credibility of the valuation analysis and allow users of the valuation report to understand the basis upon which the valuation conclusion has been derived.

3.7 Documentation and Record Retention

Proper documentation supports transparency, facilitates peer or regulatory review, and serves as a defense in the event of disputes or inquiries. The professional accountant should maintain:

- A written engagement letter defining scope, purpose, and deliverables.
- Working papers showing computations, assumptions, and sources used.
- Records of client communications, meetings, and approvals.

These documents should be retained for the duration specified by ICAN's professional standards or applicable legal requirements (typically 7 years), ensuring that they are organized, complete, and retrievable upon request.

Fair Value Measurement and Compliance with NFRS

Nepal Financial Reporting Standard (NFRS) 13, Fair Value Measurement, provides the authoritative framework for determining the fair value of assets and liabilities when such measurement is required or permitted by other standards. This section aims to clearly align fair value concepts used by professional accountants in valuation engagements with the guidance provided under NFRS, ensuring both regulatory compliance and technical consistency.

4.1 Definition of Fair Value

Under NFRS 13, fair value is defined as *“The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”* This definition emphasizes that fair value is a market-based measurement rather than an entity-specific measurement and should reflect current conditions in the principal (or most advantageous) market under orderly transaction assumptions.

4.2 NFRS Fair Value Hierarchy

NFRS 13 introduces a three-level hierarchy to prioritize the inputs used in fair value measurements:

Level 1 Inputs: Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs: Observable inputs other than Level 1 prices, such as quoted prices for similar assets in active markets.

Level 3 Inputs: Unobservable inputs that reflect the entity’s own assumptions based on the best information available.

Professional accountants must identify and disclose the level of input used in their valuation, especially in financial reporting contexts, to ensure transparency and auditability.

4.3 Recognized Valuation Techniques under NFRS

NFRS 13 recognizes three primary valuation approaches, which must be applied with professional judgment based on the nature of the asset or liability and the availability of observable inputs:

Market Approach: Utilizes prices and relevant information from market transactions for identical or comparable assets or liabilities.

Cost Approach: Reflects the amount required to replace the service capacity of an asset (i.e., current replacement cost).

Income Approach: Converts future expected amounts (e.g., cash flows or income) to present value using a discount rate.

The choice of valuation technique should maximize observable inputs and minimize unobservable inputs.



4.4 Key Application Areas in NFRS-based Reporting

Fair value measurement is required or permitted in several NFRS standards, including:

NFRS/NAS Standard	Application of Fair Value
NFRS 3 (Business Combinations)	Fair value of identifiable assets, liabilities, and goodwill
NFRS 9 (Financial Instruments)	Fair value for classification and measurement
NFRS 13 (Fair Value Measurement)	Framework for all fair value disclosures and calculations
NFRS 2 (Share-Based Payments)	Fair value of equity and liability awards
NAS 40 (Investment Property)	Measurement using fair value model (if opted)
NAS 41 (Agriculture)	Fair value less cost to sell for biological assets
NFRS 16 (Leases)	Fair value of right-of-use assets in some lease classifications

4.5 Principles for Professional Accountants to Follow

Professional accountants engaged in valuation work for financial reporting purposes must adhere to the following fair value principles:

Highest and Best Use: For non-financial assets, fair value assumes the use that is physically possible, legally permissible, and financially feasible.

Exit Price Concept: Fair value reflects the price at which an asset could be sold (or liability transferred), not acquired.

Market Participant Perspective: Assumptions must reflect those that would be made by market participants, not entity-specific perspectives.

Principal vs. Most Advantageous Market: Fair value must reflect pricing in the market where the entity would transact with the greatest volume and activity (principal), or in the absence of such, the most advantageous market.

4.6 Documentation and Disclosure Requirements

To comply with ICAN's ethical and professional standards and align with NFRS, valuation professionals must ensure the following documentation practices:

- Clear identification of valuation method and fair value hierarchy level.
- Rationale for input selection, particularly if using Level 3 inputs.
- Support for key assumptions (e.g., discount rate, growth rate, comparable company multiples).
- Disclosure of limitations, uncertainties, and reliance on expert work, if applicable.
- Detailed working papers that provide an audit trail and evidence of compliance.

Illustrative Example – Investment Property

XYZ Ltd. holds an investment property in Kathmandu that it chooses to measure under the fair value model (NAS 40). A valuation professional is engaged and applies the Income Approach using forecasted net rental income and a market-derived capitalization rate. The market lacks frequent comparable transactions, so the inputs are primarily Level 3. The valuer documents the methodology, justifies the discount rate (11%) using comparable data, and references external property appraisals. The working papers include a complete DCF model, expert reports, and sensitivity analysis.

The final fair value disclosed is NPR 75 million, with appropriate classification and narrative in the financial statement notes.

Incorporating a robust understanding of fair value principles into valuation practice is not only a matter of technical rigor but also a regulatory obligation under the NFRS framework. This section of the Manual provides clarity to professional accountants in Nepal on how to apply fair value consistently, transparently, and in full compliance with NFRS 13 and related standards.

Professional accountants are encouraged to remain vigilant to evolving interpretations, industry benchmarks and regulatory expectations as valuation continues to play a vital role in transparent and reliable financial reporting.

The Income Approach to Valuation

5.1 Overview and Principles

The Income Approach determines the value of an asset or business based on the present value of its expected future economic benefits. It is grounded in the principle that the value of any income-generating asset is equal to the present value of future cash flows it is expected to generate. This approach is particularly relevant for businesses with stable or predictable earnings and is widely used in investment decisions, financial reporting, and regulatory valuations.

Under this approach, the valuer estimates future economic benefits typically in the form of free cash flows or earnings and discounts them to their present value using an appropriate discount rate that reflects the risk and time value of money. The following methods under this approach are:

Discounted Cash Flow (DCF) Method – used when future cash flows are projected explicitly over a forecast period.

Capitalization of Earnings Method – used when stable, maintainable earnings are expected indefinitely.

Relief from Royalty Method (RFR) – used primarily for valuing intangible assets such as brands, patents, and technology by estimating royalties the owner is relieved from paying.

Multi-Period Excess Earnings Method (MPEEM) – used to value the primary intangible asset of a business (e.g., customer relationships) by isolating its contribution after providing returns to all other contributing assets.

With-and-Without Method (WWM) – values an asset by comparing the enterprise value with the asset in place against the enterprise value as if the asset did not exist; the difference represents the asset's value.

Option Pricing Models (Black-Scholes, Binomial) – used to value contingent claims such as real options embedded in projects, employee stock options, warrants, and convertible securities where the payoff depends on an underlying variable.

5.2 Discounted Cash Flow (DCF) Method

The Discounted Cash Flow (DCF) Method is a widely used and theoretically robust approach under the income-based valuation framework. It involves estimating the future free cash flows that an entity or asset is expected to generate and discounting them to present value using a discount rate that reflects the risk associated with those cash flows. The resulting value represents the intrinsic worth of the business or asset as of the valuation date.

This method is particularly appropriate for businesses with predictable and reasonably estimable cash flows and is often applied in valuing operating companies, infrastructure projects, and investment assets. Key components of the DCF method are:

- a. **Projection Period:** Typically, 3 to 10 years, based on the predictability of the business's operations. The period should capture a full business cycle or the period until cash flow stabilizes. Similarly,

for contract-based revenue secured projects such as energy plant with assured sales contract, BOOT project with revenue assurance clause longer time-period cash flow projection should be used.

- b. Free Cash Flow Estimation:** Cash flows can be calculated either by the firm (FCFF) or by the equity holders (FCFE).
- c. Discount Rate:** The Weighted Average Cost of Capital (WACC) is used for FCFF and for FCFE, the Cost of Equity is used. The rate should reflect the opportunity cost of capital and the risk profile of the business.
- d. Terminal Value:** Represents the value beyond the explicit forecast period. It can be estimated using Gordon Growth Model (Perpetuity Growth Method), or Exit Multiple Method, based on expected market value at the end of the projection.
- e. Present Value Calculation:** All forecasted cash flows and terminal value are discounted to the valuation date to determine the total enterprise or equity value.

Computation Framework

For valuation using FCFF:

$$\text{Enterprise Value} = \sum_{t=1}^n \frac{FCFF_t}{(1 + WACC)^t} + \frac{TV}{(1 + WACC)^n}$$

Where:

$FCFF_t$ = Free cash flow to firm in year t

WACC= Weighted Average Cost of Capital

TV = Terminal Value

n = Projection horizon in years

Steps in DCF Method:

1. Forecast free cash flows for a defined period (typically 3–10 years).
2. Determine a terminal value at the end of the forecast period.
3. Select an appropriate discount rate (typically Weighted Average Cost of Capital - WACC).
4. Discount projected cash flows and terminal value to present value.

Example:

Suppose a company is expected to generate the following Free Cash Flows (FCF) over 5 years, with a terminal growth rate of 3% and a discount rate of 12%.

Year	Projected FCF (NPR '000)
1	5,000
2	6,000
3	7,000
4	8,000
5	9,000



Terminal Value (TV) at Year 5:

$$TV = \frac{FCF_5 \times (1+g)}{r-g} = \frac{9000 \times 1.03}{0.12-0.03} = \text{NPR } 103,000$$

Present Value of Cash Flows + Terminal Value:

- PV of each year's FCF is calculated using: $PV = \frac{FCF}{(1+r)^n}$
- PV of Terminal Value = $\frac{103,000}{(1.12)^5} = \text{NPR } 58,445$
- Sum of all PVs = Estimated Enterprise Value

5.3 Capitalization of Earnings Method

The Capitalization of Earnings Method is a simplified form of the income approach, often used to value mature, stable businesses with predictable earnings. Unlike the Discounted Cash Flow (DCF) method which projects multiple years of future cash flow, this method converts a single representative stream of earnings into value by applying an appropriate capitalization rate.

This method is particularly useful when the business has consistent historical earnings and limited foreseeable fluctuations. It is commonly used in the valuation of small and medium-sized enterprises (SMEs), professional firms, and family-owned businesses where long-term forecasting may be impractical.

Computation Framework

Under this method, the value of the business is derived using the formula:

$$\text{Value} = \frac{\text{Maintainable Earning}}{\text{Capitalization Rate}}$$

Where:

Maintainable Earnings = Normalized net income or EBITDA

Capitalization Rate = Discount Rate – Growth Rate

Alternatively, when growth is considered:

$$\text{Value} = \frac{\text{Maintainable Earning} \times (1 + g)}{(r - g)}$$

Where:

g = sustainable growth rate

r = required rate of return or capitalization rate

Example:

If a company has normalized annual net earnings of NPR 15,000,000 and a capitalization rate of 10%, the valuation would be:

$$\text{Value} = \text{NPR } 15,000,000 / 0.10 = \text{NPR } 150,000,000$$

This method is simpler but assumes perpetual and stable cash flow, making it inappropriate for high-growth or volatile businesses.

5.4 Relief from Royalty Method (RFR)

The Relief from Royalty (RFR) Method is an income-based technique used primarily to value intangible assets such as brand names, patents, trade names, technology, and software. The underlying premise is that the owner of an intangible asset is “relieved” from paying a royalty to a third party for the right to use that asset. The value of the intangible is therefore the present value of the notional royalty stream that would otherwise be payable over the remaining useful life of the asset.

Methodology:

Step 1: Forecast the revenue attributable to the intangible asset over its remaining useful life.

Step 2: Apply an appropriate royalty rate (derived from comparable licensing agreements, royalty rate databases, or industry benchmarks) to the projected revenue to arrive at a notional royalty stream.

Step 3: Apply a tax effect to obtain after-tax royalty savings.

Step 4: Discount the after-tax royalty savings to present value using an appropriate discount rate reflecting the risk of the intangible asset (typically the WACC or an asset-specific rate).

Step 5: Add any tax amortization benefit (TAB), if applicable under the relevant jurisdiction.

The RFR method is widely accepted under NFRS 13 and IVS for the valuation of intangible assets in purchase price allocation (PPA), impairment testing, and licensing negotiations. The selection of the royalty rate is critical: it must be corroborated by arm’s length transactions in comparable licensing arrangements.

5.5 Multi-Period Excess Earnings Method (MPEEM)

The Multi-Period Excess Earnings Method (MPEEM) is an income-based approach used to value the primary or most significant intangible asset of a business typically customer relationships, order backlogs, or core technology. It isolates the cash flows attributable to the subject intangible by deducting “contributory asset charges” (CACs) notional returns on all other assets (tangible and intangible) that contribute to the generation of those cash flows. The residual “excess earnings” are then discounted to present value.

Methodology:

Step 1: Project the total revenues and operating cash flows of the business attributable to the subject intangible assets over its remaining useful life.



Step 2: Deduct contributory asset charges (CACs) – fair returns on all supporting assets such as working capital, fixed assets, assembled workforce, and other intangibles. CACs are typically computed as the fair value of each contributing asset multiplied by an appropriate rate of return.

Step 3: Apply applicable taxes to arrive at after-tax excess earnings.

Step 4: Discount the after-tax excess earnings to present value using an appropriate discount rate (which may carry a premium over the enterprise WACC to reflect the higher risk of the intangible). **Step 5:** Add the tax amortization benefit (TAB) where applicable.

The MPEEM is the most commonly applied method for valuing customer-related intangibles in purchase price allocations (PPA) under NFRS 3 (Business Combinations). Its principal challenge lies in the identification and quantification of appropriate CACs, which require careful judgement and cross-referencing with market-derived rates of return.

5.6 With-and-Without Method (WWM)

The With-and-Without Method (WWM) values an intangible asset by comparing two scenarios: (i) the value of the enterprise with the subject intangible asset in place (the “with” scenario), & (ii) the value of the enterprise as if the intangible asset did not exist (the “without” scenario).

The difference between these two enterprise values represents the value attributable to the intangible asset. This method is particularly appropriate for intangibles whose impact can be measured in terms of incremental revenue, cost avoidance, or time savings – such as non-compete agreements, know-how, licences, and regulatory approvals.

Methodology:

Step 1: Prepare a DCF model for the enterprise including the subject intangible (the “with” scenario), projecting revenues, costs, and cash flows assuming the intangible continues to be used.

Step 2: Prepare a modified DCF model for the enterprise assuming the subject intangible does not exist (the “without” scenario), adjusting revenues downward (or costs upward) to reflect the loss of the intangible’s economic benefit and modelling any transition costs or ramp-up periods needed to rebuild the capability.

Step 3: Discount both sets of cash flows to present value.

Step 4: The value of the intangible asset = PV (“with” scenario) – PV (“without” scenario).

The WWM is conceptually straightforward but requires robust modelling of the “without” scenario, including realistic assumptions about lost revenue, customer attrition, re-creation costs, and time to recreate the capability. It is less commonly applied than MPEEM or RFR for customer relationships or technology but is well-suited for non-compete covenants and unique regulatory licenses.

5.7 Option Pricing Models: Black-Scholes and Binomial Models

Option pricing models are income-based methods used to value financial instruments and real assets whose payoff is contingent on an underlying variable crossing a threshold. In a valuation context, they are

applied to employee stock options (ESOPs), warrants, convertible instruments, real options embedded in capital projects (e.g., the option to expand, abandon, or defer), and equity in highly leveraged or distressed companies (where equity may be viewed as a call option on enterprise assets).

Black-Scholes Model:

The Black-Scholes Model (BSM) provides a closed-form solution for pricing European-style options (exercisable only at expiry). Its key inputs are:

- (i) current value of the underlying asset (S);
- (ii) exercise or strike price (K);
- (iii) time to expiry (T);
- (iv) risk-free rate (r); and
- (v) volatility of the underlying asset (σ).

The BSM assumes continuous trading, constant volatility, log-normally distributed asset returns, and no dividends (though extensions accommodate dividends). It is best suited for valuing exchange-traded options, plain-vanilla warrants, and ESOPs where these assumptions are reasonably satisfied.

Binomial Model:

The Binomial Model constructs a discrete price tree in which the underlying asset can move up or down at each time step by specified factors. By working backwards through the tree using risk-neutral probabilities, the model computes the option value at each node, allowing for early exercise (American-style options). It is more flexible than BSM and can accommodate changing volatility, dividends, and vesting conditions. The Binomial Model is the preferred method for valuing ESOPs with performance conditions, convertible debt with call/put features, and real options where management decisions can be made at discrete points. As the number of time steps increases, the Binomial Model converges to the Black-Scholes price for European options.

Professional accountants applying option pricing models must exercise care in estimating volatility (whether implied from market data or calculated from historical returns), selecting the appropriate risk-free rate, and ensuring the model chosen is fit for the specific type of option or contingent claim being valued.

5.8 Estimation of Future Cash Flows

The accuracy and reliability of a valuation under the Income Approach, particularly the Discounted Cash Flow (DCF) method, are highly dependent on the quality of projected cash flows. Estimating future cash flow requires a thorough understanding of the business, its industry, historical performance, strategic plans, and the external economic environment. Professional accountants must ensure that such projections are based on reasonable and supportable assumptions.

This section outlines the methodology, components, and key considerations in projecting future cash flows for valuation purposes.



Key Considerations:

- a. **Revenue Growth:** Estimated based on past growth trends, market demand, capacity utilization, and expansion plans and pricing strategies, customer contracts, and competition.
- b. **Operating Costs:** Include cost of goods sold (COGS), salaries, utilities, and other expenses. Cost structures may change due to economies of scale, automation, or input price fluctuations.
- c. **Earnings Before Interest and Taxes (EBIT):** Derived after deducting operating expenses from projected revenue. Reflects the core profitability of the business.
- d. **Taxes:** Effective tax rate applied to EBIT to determine Net Operating Profit After Tax (NOPAT). Adjustments must be made for tax holidays, carried-forward losses, or minimum tax obligations.
- e. **Capital Expenditures (CapEx):** Investment in fixed assets (e.g., plant, equipment, IT systems) necessary to maintain or grow operations. Projected based on replacement needs, expansion plans, or regulatory compliance.
- f. **Working Capital Changes:** Reflects additional cash tied up (or released) due to changes in inventory, receivables, and payables. Growing businesses usually require higher working capital.
- g. **Free Cash Flow (FCF)**

For enterprise valuation (FCFF):

$$\text{FCFF} = \text{EBIT} \times (1 - \text{Tax Rate}) + \text{Depreciation} - \text{CapEx} - \text{Change in Working Capital}$$

For equity valuation (FCFE):

$$\text{FCFE} = \text{Net Income} + \text{Depreciation} - \text{CapEx} - \text{Change in Working Capital} - \text{Debt Repayment} + \text{New Borrowings}$$

5.9 Key Steps in Projecting Cash Flows

Cash flow projection is the cornerstone of any income-based valuation model. Whether applying the Discounted Cash Flow (DCF) method or Capitalization of Earnings, the credibility of the valuation is directly tied to the quality, reasonableness, and defensibility of the projected cash flows.

1. Historical Analysis

- Analyze 3–5 years of historical financial statements to identify trends in revenue, cost margins, EBITDA, working capital, and capital expenditures.
- Normalize for non-recurring or unusual transactions.

2. Revenue Forecasting

- Base revenue growth projections on capacity, market demand, industry forecasts, order pipelines, and pricing strategies.
- Ensure alignment with economic outlooks, such as GDP growth and inflation assumptions.

3. Cost Estimation

- Project operating costs (COGS, Selling General & Administrative expenses (SG&A), etc.) in line with historical margins or strategic plans.
- Adjust for expected efficiency gains or inflationary effects.

4. Working Capital Changes

- Estimate annual changes in working capital components (inventory, receivables, payables) to reflect realistic cash needs.

5. Capital Expenditure and Asset Reinvestment

- Include projected capital investments needed to sustain or expand operations.
- Reinvestment policies must align with the company's strategic objectives.

6. Taxation

- Apply effective corporate tax rate applicable in Nepal (e.g., 25% standard rate unless otherwise applicable).
- Adjust for tax shields, carryforwards, or tax holidays, if justified.

7. Terminal Value Estimation

- Once projections are extended over a finite horizon (typically 5–10 years), apply a terminal value to capture ongoing operations using Gordon Growth or Exit Multiple approaches.

5.10 Selection of Discount and Capitalization Rates

The discount rate is a critical input in any valuation under the income approach. It reflects the risk-adjusted rate of return expected by an investor and is used to convert future expected cash flows into their present value. In the Capitalization of Earnings Method, a closely related concept capitalization rate is used to apply a single-period valuation. The proper estimation of these rates is vital to producing a credible and defensible valuation.

a. Free Cash Flow to Firm (FCFF) Approach:

The appropriate discount rate is the Weighted Average Cost of Capital (WACC), which accounts for the cost of both equity and debt, weighted by their respective proportions in the capital structure.

$$\text{WACC} = \left(\frac{E}{E + D} \right) \times R_e + \left(\frac{D}{E + D} \right) \times R_d \times (1 - T)$$

Where:

E = Market value of equity

D = Market value of debt

R_e = Cost of equity

R_d = Cost of debt

T = Effective tax rate

b. Free Cash Flow to Equity (FCFE) Approach:

The appropriate discount rate is the Cost of Equity (CoE), representing the return required by equity investors.



$$R_e = R_f + \beta \times (R_m - R_f)$$

Where:

R_f = Risk-free rate (e.g., 10-year government bond yield in Nepal)

β = Beta coefficient (measure of systematic risk)

R_m = Expected market return

In the Nepalese context, due to limited availability of local equity market data, industry betas and adjusted international inputs are often used with necessary adjustments for country risk.

For evaluating the project in national context within Nepal, risk free rate could be derived from development bond data published by public debt management office and Nepal Rastra Bank. Market risk premium and stock beta data could be derived from trading volume data in stock exchange.

The Statistical Calculation of Beta

Beta is mathematically defined as the covariance of the asset's returns with the market's returns, divided by the variance of the market's returns.

The Formula:

$$\beta_i = \frac{COV(R_i, R_m)}{Var(R_m)}$$

Where:

$COV(R_i, R_m)$: Covariance between stock and market returns.

$Var(R_m)$: Variance of market returns.

To calculate Beta (β) statistically, the historical returns of a specific asset against a benchmark market index need to be analyzed. Following is an example of computation of beta:

1. The Data Set

Assume the Risk-Free Rate (R_f) is 5% per annum (approx. 0.42% monthly).

Year	Stock Return (R_i)	Market Return (R_m)
1	2%	1%
2	3%	2%
3	-1%	-1%
4	5%	3%
5	1%	0%
Average	$\bar{R}_i = 2\%$	$\bar{R}_m = 1\%$

2. Step-by-Step Calculation

To find Beta, we need the Covariance of the returns and the Variance of the market.

a. Calculate Deviations from the Mean

We subtract the average return from each year's actual return.

Year	$(R_i - \bar{R}_i)$	$(R_m - \bar{R}_m)$	Product: $(DEV_i \cdot DEV_m)$	Market Sq: $(R_m - \bar{R}_m)^2$
1	$2 - 2 = 0$	$1 - 1 = 0$	$0 \times 0 = 0$	$0^2 = 0$
2	$3 - 2 = 1$	$2 - 1 = 1$	$1 \times 1 = 1$	$1^2 = 1$
3	$-1 - 2 = -3$	$-1 - 1 = -2$	$-3 \times -2 = 6$	$(-2)^2 = 4$
4	$5 - 2 = 3$	$3 - 1 = 2$	$3 \times 2 = 6$	$2^2 = 4$
5	$1 - 2 = -1$	$0 - 1 = -1$	$-1 \times -1 = 1$	$(-1)^2 = 1$
Sum			14	10

b. Calculate Covariance and Variance

Using n-1 for a sample (where n=5):

$$Cov(R_i, R_m) = \frac{\sum(DEV_i, DEV_m)}{(n - 1)} = \frac{14}{4} = 3.5$$

$$Var(R_m) = \frac{\sum(DEV_m)^2}{(n - 1)} = \frac{10}{4} = 2.5$$

c. The Resulting Beta

Apply the Beta formula:

$$\beta = \frac{Cov(R_i, R_m)}{Var(R_m)} = \frac{3.5}{2.5} = 1.4$$

Interpretation: A Beta of 1.4 indicates that the stock is 40% more volatile than the market. If the market rises by 10%, this stock is expected to rise by 14%.

Adjusting Beta for Leverage

When comparing companies or performing valuations (like a Due Diligence Assessment), distinction between business risk and financial risk shall be made. Since debt increases the volatility of equity returns, we "un-lever" and "re-lever" Beta to make it comparable.

Unlevered Beta (Asset Beta)

This removes the effect of financial leverage to isolate the risk of the underlying business operations.



$$\beta_u = \frac{\beta_l}{1 + (1 - t) * \frac{D}{E}}$$

Re-levered Beta (Equity Beta)

To find the Beta for a specific target capital structure:

$$\beta_u * [1 + (1 - t) * \frac{D}{E}] = \beta_l$$

Here,

β_l : Levered Beta (Equity Beta)

β_u : Un-levered Beta (Asset Beta)

t: Corporate Tax Rate

D/E: Debt to equity ratio

c. Capitalization Rate in Earnings-Based Valuation

This method is suitable for businesses with stable earnings and modest growth prospects. The capitalization rate is essentially the discount rate minus the long-term sustainable growth rate:

Capitalization Rate = $r - g$

Where:

r = required rate of return (e.g., cost of equity)

g = expected perpetual growth rate of earnings

It is critical to disclose the method, source of inputs, and rationale for chosen discount rates in the valuation report.

5.11 Terminal Value Determination

The terminal value captures the value of the business beyond the explicit forecast period and is a key component in the DCF model. It can be estimated using the Gordon Growth Model (also called the Perpetuity Growth Model).

Using the projected Year 5 FCF of NPR 9,000,000, a perpetual growth rate of 3%, and a discount rate (WACC) of 12%, the terminal value at the end of Year 5 is calculated as:

$$TV = \frac{FCF_5 \times (1 + g)}{r - g} = \frac{9,000,000 \times 1.03}{0.12 - 0.03} = \frac{9,270,000}{0.09} = \text{NPR } 103,000,000$$

This terminal value is then discounted to present value using WACC (12%) over 5 years:

$$\text{Present Value of TV} = \frac{103,000,000}{(1.12)^5} = \text{NPR } 58,444,966$$

The Gordon Growth Model is the most widely used method for the computation of terminal value. However, as an alternative to the Gordon Growth Model, one can use Exit Multiple Method by applying a valuation multiple (e.g., EV/EBITDA, P/E) to the final year's metric for the computation of the terminal value.

5.12 Limitations and Practical Challenges

While the income approach, especially the DCF method, is widely regarded as a sound valuation technique, it faces certain practical challenges:

- a. **High Sensitivity to Assumptions:** In the above example, small changes in the WACC or the terminal growth rate can lead to large differences in valuation. A WACC of 10% instead of 12% would increase the present value of terminal value substantially.
- b. **Uncertainty in Projections:** The accuracy of the valuation depends heavily on the reliability of the projected cash flows. Forecasting five years of cash flow requires strong business insight and judgment. Unexpected changes in revenue, expenses, or capital requirements could invalidate the projections.
- c. **Estimating Terminal Value:** As seen in the example, the terminal value contributes a large portion of the total valuation. Estimating a perpetual growth rate is inherently subjective and often debated.
- d. **Availability of Reliable Inputs:** Private companies may lack consistent historical data or robust forecasting models. Without reliable data, estimating cost of capital and future performance becomes more speculative.
- e. **Unsuitability for Certain Entities:** The DCF approach may not be suitable for early-stage startups, distressed entities, or companies with unpredictable or negative cash flows. In such cases, market-based or asset-based approaches may provide better reliability.

5.13 Conclusion

The Income Approach provides a structured and forward-looking method to estimate value based on anticipated economic benefits. It is particularly effective for businesses with predictable or projectable cash flows.

The DCF method offers detailed insights into value drivers and future expectations, while the Capitalization of Earnings method is suited for stable, mature businesses with steady earnings. Accurate estimation of cash flow and selection of appropriate discount or capitalization rates are critical to credibility.

Professional accountants must exercise informed judgment, ensure assumptions are well supported, and maintain transparency throughout the process. Careful documentation of assumptions, sensitivity analysis, and transparent communication of limitations are critical to enhance the credibility of the valuation. When applied with diligence, the Income Approach yields robust, principle-based valuations aligned with international and local best practices.



Practice Notes: Income Approach (Discounted Cash Flow Method)

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Scope, Purpose, and Premise of Valuation					
1.	Purpose of Valuation	The engagement purpose must be identified at the start. It governs the standard of value applied, the adjustments warranted, and the nature of projections. Common purposes include mergers and acquisitions, financial reporting, dispute resolution, regulatory compliance, financing, and restructuring.	Document purpose in writing before commencing work. Confirm consistency between stated purpose and standard of value applied. Reassess assumptions if the purpose changes during the engagement.	<i>Misaligning purpose with the standard of value e.g., using investment value assumptions in a market value engagement.</i> <i>Omitting a statement of purpose from the valuation report.</i>	[Listed Co.] Purpose is often linked to exchange listing rules, merger & acquisition, scheme of arrangement under corporate law, or related-party transaction pricing requirements under securities regulations. [SME] Typical purposes include owner exit, partner buyout, succession planning, bank financing, or private equity entry. Investment value or fair value is most commonly applicable. [Project] Purpose is usually project financing (lender due diligence), concession grant, or asset monetization. Market value or investment value is the typical standard. [Private Co.] Most frequent purposes: promoter or founder exit, M&A, equity compensation scheme pricing, or dispute resolution. The applicable standard depends on the nature of the transaction. [Tech Co.] Common purposes include venture capital or private equity fundraising, equity compensation scheme valuation for regulatory compliance, or strategic acquisition. Fair value for financial reporting is common for larger entities. [Other Entity] For trusts, cooperatives, and public sector entities, purpose may include asset transfer, public-private partnership pricing, or statutory compliance with sector-specific regulations.
2.	Standard of Value	The standard of value defines the hypothetical conditions under which the valuation is conducted. Market Value assumes a hypothetical arm's-length buyer and seller. Fair Value (for financial reporting) requires market participant assumptions. Investment Value reflects a specific acquirer's objectives and synergies. Equitable Value is used in dispute and shareholder contexts.	Identify the applicable standard based on the engagement purpose State the standard explicitly in the scope of work and report. Adjust all assumptions to be consistent with the chosen standard particularly regarding synergies and market conditions.	<i>Applying investment value assumptions (including buyer-specific synergies) in a market value engagement.</i> <i>Conflating financial reporting fair value with the equitable value concept used in shareholder disputes.</i>	[Listed Co.] Fair value per applicable financial reporting standards governs impairment testing, business combination accounting, and financial instrument measurement. Confirm the relevant accounting standard in force. [SME] Market value or investment value is most common. For bank-mandated valuations, the lending institution may specify its own definition of value confirm and document this. [Project] Investment value is most relevant for project finance, market value for the sale of project rights or concession interests. Lenders use credit-adjusted value concepts internally. [Private Co.] Market value applies for arm's-length transactions, investment value for strategic acquisitions. In dispute contexts, the applicable corporate law or arbitration agreement may define the relevant standard. [Tech Co.] For equity compensation scheme valuations required under tax regulations, the applicable authority prescribes the methodology. For venture transactions, investment value is the operative concept. [Other Entity] Government or regulated entities may be subject to sector-specific definitions of value prescribed by the relevant regulatory authority. Confirm and apply the prescribed standard.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
3.	Premise of Value	Going concern is the default premise for DCF. It assumes the business will continue to operate and generate future cash flows indefinitely. Orderly or forced liquidation premises apply where viability is in doubt, the business is being wound up, or the purpose involves distressed asset pricing.	Assess going concern indicators before adopting the DCF method. Obtain the auditor's going concern opinion where available. Substantiate going concern through projected debt service coverage and liquidity analysis.	<i>Adopting going concern despite persistent operating losses and inability to service debt obligations.</i> <i>Failing to consider alternative premises when material going concern doubt exists.</i>	[Listed Co.] For listed companies, going concern is the norm. Where regulatory proceedings, insolvency filings, or material adverse events are underway, evaluate whether a liquidation premise is more appropriate. [SME] SMEs with high leverage and thin interest coverage ratios require careful going concern assessment. A dual-premise valuation going concern and liquidation may be appropriate for lending engagements. [Project] Going concern for a project entity is linked to the concession or offtake agreement term. Post-term value may require a residual or liquidation premise rather than a perpetuity assumption. [Private Co.] Distressed private companies may warrant an orderly liquidation premise. Where formal insolvency or restructuring proceedings are pending, align the premise with the applicable insolvency framework. [Tech Co.] Pre-revenue or early-stage companies may not satisfy conventional going concern indicators. The business plan, funding runway, and committed investor support must substantiate the going concern assumption. [Other Entity] For infrastructure concessions with a defined remaining life, a partial going concern and residual liquidation structure is more appropriate than an indefinite perpetuity assumption.
4.	Valuation Date	All assumptions financial data, discount rates, market comparables, and macro variables must be calibrated to a single specified valuation date. Events occurring after this date are generally excluded unless the purpose specifically requires otherwise.	State the valuation date prominently in the scope of work and in the report. Confirm all market data sources are drawn from the valuation date or the nearest available date. Document the treatment of any material post-date events and the reasons for their inclusion or exclusion.	<i>Using a discount rate drawn from a materially different period than the financial data.</i> <i>Mixing current and historical market data without explicit disclosure and rationale.</i>	[Listed Co.] For listed companies, the valuation date is typically the board resolution date, the record date for a corporate action, or the measurement date specified under applicable financial reporting standards. [SME] The valuation date is typically the last audited balance sheet date or a date agreed between the parties. Where more than six months have elapsed since the last audited accounts, interim data should be incorporated. [Project] For project finance engagements, the valuation date is typically the financial close date or the date specified in the concession or project agreement. [Private Co.] For M&A, typically the board approval date or signing date. For dispute resolution, the measurement date may be prescribed by the court, arbitral tribunal, or applicable corporate law. [Tech Co.] For equity compensation valuations, the measurement date is typically the grant date or exercise date as specified by the applicable tax or regulatory authority. [Other Entity] For regulatory or statutory valuations, the measurement date is typically prescribed by the relevant authority. Document the source of the prescribed date.



Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
5.	Level of Value and Interest Being Valued	DCF typically produces Enterprise Value (the total value of the business to all capital providers). The interest being valued by controlling equity, minority equity, or enterprise determines what adjustments are required. The enterprise-to-equity bridge deducts net financial debt and adjusts for non-operating assets.	Clearly distinguish enterprise value from equity value in the report. Compute the enterprise-to-equity bridge: EV minus net financial debt, plus non-operating assets. Assess the applicability of Discount for Lack of Control (DLOC) and Discount for Lack of Marketability (DLOM) at the conclusion stage.	<i>Confusing enterprise value with equity value per share.</i> <i>Applying DLOC and DLOM cumulatively without individually justifying each.</i>	[Listed Co.] Market capitalization provides an observable minority, marketable equity value. A control premium is warranted for acquirer-level valuations typically observed at 20–40% above the prevailing market price in control transactions. [SME] DLOM is material for SMEs, which have no liquid secondary market. Empirical ranges of 15–35% are supported by restricted stock and pre-IPO studies; each application requires individual justification. [Project] Projects are typically valued at the enterprise or project level. Equity value is derived by deducting project debt, which is often structured as non-recourse. Residual equity at end of concession may be zero or minimal. [Private Co.] Minority interests in private companies typically attract both DLOC (15–25%) and DLOM (15–35%). These are applied multiplicatively not additively. [Tech Co.] For equity compensation and minority shareholding valuations, DLOC and DLOM apply. Reference applicable regulatory guidance and empirical studies when determining the quantum of each discount. [Other Entity] For cooperatives, mutual entities, and non-profit organizations, the concept of equity value requires careful definition since member rights may differ substantially from standard equity entitlements.
Historical Financial Analysis and Normalization					
6.	Period of Historical Analysis	Analyze a minimum of three to five years of audited financial statements to identify trends in revenue, margins, capital expenditure intensity, and working capital. Identify any structural breaks, changes in business model, or changes in accounting policy during the period.	Use audited financials as the primary source; note any restatements or policy changes. Identify and explain structural breaks in the historical trend. Compute three-year and five-year CAGRs for key performance metrics.	<i>Relying on a single year as representative of ongoing performance.</i> <i>Using management accounts without disclosure where audited financials exist.</i>	[Listed Co.] Audited annual reports and periodic financial disclosures provide a rich data set including segment information. Use published financials as the primary source. [SME] Many SMEs maintain only tax-purpose accounts. Where audited financials are unavailable, perform enhanced analytical procedures and disclose the limitation prominently in the report. [Project] For greenfield projects, no operating history exists. Base projections on technical feasibility studies, independent engineer reports, and benchmarks from comparable operating projects. [Private Co.] Closely held companies often have limited external disclosure. Related-party transactions and owner-managed cost structures require thorough normalization before trend analysis is meaningful. [Tech Co.] Early-stage companies may have only one or two years of operating history. Weight unit economics (cohort data, retention curves, CAC/LTV) alongside financial trends. [Other Entity] For trusts and cooperatives, the applicable accounting framework may differ from commercial standards. Adjust reported figures to a comparable basis before trend analysis.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
7.	Non-Recurring and Extraordinary Items	Exclude one-off items from normalized earnings: gains or losses on asset disposals, insurance proceeds, restructuring charges, impairment losses, litigation settlements, and any event-specific distortions. Each adjustment must be individually identified, quantified, and documented.	Classify each item as recurring or non-recurring with supporting evidence. Quantify the post-tax impact of each normalization adjustment. Document all adjustments in the work file and summarize them in the report.	<i>Treating recurring losses as non-recurring to inflate normalized earnings.</i> <i>Normalizing away structural changes in the business by labelling them as one-off.</i>	[Listed Co.] Non-recurring items are typically disclosed in the notes to accounts or management discussion. Cross-check against exceptional items and discontinued operations lines in the income statement. [SME] Owner discretionary expenses personal travel, family member salaries above market, personal insurance premiums are common non-arm's-length items requiring systematic adjustment. [Project] Pre-commercial operation date expenditures and ramp-up losses are non-recurring in nature. Identify and exclude these from the normalized operating base. [Private Co.] Related-party management fees, promoter compensation above market rates, and non-arm's-length property rentals are the most frequent adjustments in private company valuations. [Tech Co.] Share-based compensation expense is non-cash but is a real economic cost. Add it back to derive cash-based EBITDA for comparability but recognize it when computing economic earnings. [Other Entity] Capital grants recognized as income, government subsidies, and one-off regulatory settlements should be identified and excluded from the normalized recurring income base.
8.	Non-Operating Asset Identification	Identify all assets that do not contribute to core operating cash flows: surplus land, investment properties, shareholdings in other entities, excess cash above operating requirements, and idle or non-essential assets. These are valued independently and added to the DCF-derived operating enterprise value.	List all non-operating assets at the start of the engagement. Value each non-operating asset independently at current market value. Add non-operating asset values to the DCF-derived enterprise value after the main model.	<i>Including non-operating income in projected operational cash flows this double-counts value.</i> <i>Using the book value of investments or surplus assets as a proxy for their current market value.</i>	[Listed Co.] Listed companies often hold cross-shareholdings in associates and joint ventures and may own investment properties. Apply sum-of-the-parts (SOTP) methodology: value each component separately. [SME] Non-operating landholdings are common in family-managed SMEs. An independent property valuation is required to determine current market value. [Project] Surplus cash above the minimum operating balance and debt service reserve accounts are non-operating financial assets. Treat the DSRA balance as a restricted asset and add it to enterprise value separately. [Private Co.] Private companies frequently hold surplus deposits, diversified investments, and non-core equity stakes. Each must be valued at current realizable value and added to the enterprise value separately. [Tech Co.] Intellectual property not currently generating revenue but with identifiable future optionality may be treated as a non-operating asset and valued using probability-weighted scenario analysis or option pricing. [Other Entity] For holding companies and investment entities, substantially all assets are non-operating. SOTP net asset value methodology is the primary approach rather than DCF on consolidated cash flows.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
9.	Related-Party and Non-Arm's-Length Transactions	Adjust for all transactions not conducted at market prices between the subject entity and its related parties. Common items include owner or promoter salaries above or below market, management fees charged by affiliated entities, property rentals at non-market rates, and inter-company loans at non-commercial interest rates.	Identify all related-party relationships from ownership structure and notes to accounts. Benchmark each related-party transaction against arm's-length market references. Document each adjustment with the market reference used as the basis	<i>Missing undisclosed related-party arrangements that are embedded in operating costs.</i> <i>Inadequate benchmarking of owner compensation using the reported amount without assessing market equivalence.</i>	[Listed Co.] Related-party disclosures in audited accounts are the starting point. Cross-check with ownership structure and director relationships to identify undisclosed arrangements. [SME] Owner-managed SMEs frequently have the most extensive related-party adjustments. Assess every significant cost item against its market equivalent before accepting as arm's-length. [Project] O&M contracts, engineering services, and construction contracts with related entities are the primary areas of concern. Benchmark contract rates against independent market tenders. [Private Co.] Promoter loans to the company at non-commercial rates, intra-group cross-guarantees, and shared service arrangements at non-arm's-length costs require systematic identification and adjustment. [Tech Co.] Founders often receive below-market compensation in early stages. Adjust upward to market-rate cost to avoid overstating normalized EBITDA. [Other Entity] For family trusts and cooperatives, transactions with associated family members or member-entities require the same arm's-length assessment applied to commercial entities.
Revenue and Growth Assumptions					
10.	Forecast Horizon	The explicit forecast period must be long enough for the business to reach a normalized steady state typically five to ten years. Longer horizons are warranted for high-growth, infrastructure, or ramp-up businesses; shorter periods for stable mature businesses where a steady state is already evident.	Select the horizon based on the business's lifecycle stage and time to steady state. Confirm that the terminal growth rate is appropriate at the end of the period. Document the rationale for the period selected.	<i>Choosing five years mechanically without assessing whether steady state is achieved.</i> <i>Using a very short period that pushes a disproportionate share of value into the terminal value.</i>	[Listed Co.] For large stable companies, five years is typically sufficient. For conglomerates with multiple growth businesses at different lifecycle stages, seven to ten years may be warranted. [SME] Five years is standard. Where the business is in an early growth phase, seven years may be appropriate. Management projections beyond three years should be treated with heightened skepticism. [Project] The forecast horizon should match the concession, power purchase, or offtake agreement term. Beyond that term, a residual or terminal value assumption requires specific substantiation. [Private Co.] Five to seven years is typical. Where the business plan involves specific milestones capacity expansion, market entry, or product launch, the horizon must capture those inflection points. [Tech Co.] High-growth companies typically require a ten-year explicit period with a transitional fade phase. [Other Entity] For cyclical businesses, the forecast horizon should encompass at least one complete business cycle to ensure normalized cash flows are captured.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
11.	Revenue Growth Rate Basis and Triangulation	Revenue projections must be triangulated from multiple independent sources: historical compound annual growth rate, management guidance assessed against its track record, industry growth data, market size analysis, and macro demand drivers. Near-term projections should be anchored by contracted or highly visible revenues.	Cross-check management forecasts against historical forecast accuracy. Use market size and market share analysis to bound the growth assumption. Decompose growth into volume and price components separately.	<i>Accepting management guidance without independent corroboration.</i> <i>Applying a single flat growth rate across the entire explicit forecast period.</i>	[Listed Co.] Published analyst consensus forecasts and management guidance from investor communications are useful reference points. Cross-check against sector research to identify divergences. [SME] Backlog orders, signed distribution agreements, and installed capacity data provide near-term anchors. Industry association and credit data support medium-term assumptions. [Project] Revenue is typically contractually determined: installed capacity multiplied by contractual tariff or usage fee. Volume risk generation factor, traffic, throughput is the primary variable. [Private Co.] Revenue projections should be validated against the sales pipeline, customer renewal rates, and market share trends. Historical accuracy of prior management forecasts should be assessed. [Tech Co.] Key metrics: Annual Revenue Growth or MRR growth, active user trends, average revenue per user, cohort retention, and customer acquisition cost relative to lifetime value. Revenue projections must be built bottom-up from unit economics. [Other Entity] For cyclical businesses, use mid-cycle normalized revenue growth rather than projecting from peak or trough conditions. Cross-check with long-run commodity price assumptions where input costs drive revenue.
12.	Revenue Growth Rate Medium and Long Term	Medium-term growth projections (years four to seven) should reflect identified market expansion drivers, moderating toward an industry steady state. The terminal growth rate must not exceed the long-run nominal GDP growth rate of the relevant economy. Sustained above-GDP revenue growth in perpetuity is mathematically unsustainable.	Benchmark medium-term growth against industry compound annual growth rates. Model a gradual convergence from current growth to the terminal growth rate. Confirm the terminal growth rate does not exceed nominal GDP growth.	<i>Projecting above-GDP growth indefinitely without specific market-share or new-market justification.</i> <i>Applying real GDP growth as the terminal rate in a nominal cash flow model.</i>	[Listed Co.] Large listed companies in mature sectors typically converge to GDP-level terminal growth. Companies with demonstrable network effects or structural competitive advantages may justify the upper bound of the range. [SME] Apply a conservative terminal growth rate to reflect higher execution risk and the competitive dynamics likely to erode above-average returns as the business matures. [Project] Beyond the contract or concession term, a going-concern terminal growth rate may not be appropriate. Use a residual asset value or zero terminal growth if no continuation is contractually assured. [Private Co.] Standard terminal growth for private operating companies should be grounded in the long-run growth of the industry and the broader economy individual company ambitions do not define the terminal rate. [Tech Co.] Companies approaching maturity should use a terminal growth rate consistent with the broader economy. Early-stage models should not use a perpetuity terminal value use a time-bounded model or an exit multiple instead. [Other Entity] For seasonal or commodity-driven businesses, terminal growth should reflect mid-cycle conditions rather than being extrapolated from a peak or trough revenue base.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Operating Cost and Profitability Assumptions					
13.	Cost Structure Classification	Classify all costs as variable (proportional to revenue), semi-variable (partially fixed), or fixed (independent of volume within a relevant range). This classification determines how margins evolve as revenue scales up or down and is essential for credible scenario modelling.	Decompose cost of goods sold and operating expenses into fixed and variable components. Benchmark the cost structure against comparable sector peers. Test EBITDA sensitivity to a revenue shortfall scenario as a validation check.	<i>Treating all costs as variable overstates operating leverage on the downside.</i> <i>Treating all costs as fixed overstates margin improvement as revenue scales.</i>	[Listed Co.] Published annual accounts typically provide sufficient cost line detail. Use segmental cost disclosures for greater precision where available. [SME] Fixed costs rent, owner salaries, administrative overhead often constitute a high proportion of total costs in SMEs, creating significant operating leverage in both directions. [Project] Operating costs for project entities are primarily fixed O&M contracts, insurance, and asset management fees. EBITDA is therefore highly sensitive to revenue volume assumptions. [Private Co.] After removing related-party distortions, the fixed vs. variable cost split must be re-assessed against market-rate equivalents to produce a meaningful normalized cost structure. [Tech Co.] Cloud infrastructure and hosting costs scale with usage (variable); R&D and product development are largely fixed; sales and marketing is semi-variable. Model each component separately. [Other Entity] For regulated utilities, operating costs may be subject to regulatory pass-through mechanisms. Identify which costs are recoverable in the tariff and which are absorbed by the business.
14.	Gross Margin and Input Cost Assumptions	Project gross margin based on the historical trend, input cost escalation assumptions, labor cost inflation, procurement efficiency opportunities, and the competitive pricing environment. Benchmark against sector peers to test plausibility.	Distinguish between input cost inflation and labor cost inflation in the model. Assess whether pricing power is sufficient to pass through input cost increases. Benchmark gross margin trajectory against comparable companies.	<i>Assuming margin expansion alongside revenue growth without identifying the operational source of the improvement.</i> <i>Ignoring commodity or import cost cycles that affect input costs for manufacturing businesses.</i>	[Listed Co.] Gross margin trends for listed companies are publicly observable. Any projected improvement over the peer median must be substantiated by demonstrated competitive advantages. [SME] SMEs often face higher input cost inflation than their ability to raise prices, creating structural margin compression. Model this spread explicitly rather than assuming pass-through. [Project] Operating cost escalation for projects is often contractually defined O&M contracts specify annual escalation mechanisms. Use these contractual escalation rates in the model. [Private Co.] For import-dependent businesses, exchange rate movements are a primary driver of cost inflation. Distinguish between domestic cost inflation and currency-driven import cost changes. [Tech Co.] Salary costs are the dominant variable for tech businesses and have historically escalated faster than general consumer price inflation in most markets. Model sector-specific wage inflation. [Other Entity] For agricultural processors and commodity-linked businesses, model raw material costs separately using commodity price forecasts rather than blending into a general cost inflation assumption.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
15.	EBITDA Margin Trajectory	Project EBITDA margin on a year-by-year basis from the current normalized level toward a sustainable steady state. Each change in margin must be substantiated by a specific operational driver. The terminal EBITDA margin must be benchmarked against the long-run industry equilibrium.	Identify the specific driver behind each step change in projected margin. Benchmark the terminal margin against the median of the peer group. Confirm margins are consistent with the competitive dynamics and barriers to entry in the industry	<i>Projecting margin improvements in the outer years without identifiable operational drivers.</i> <i>Setting a terminal margin materially above the peer median without a demonstrably sustainable competitive advantage.</i>	[Listed Co.] Observable peer EBITDA margins provide a benchmark for the terminal margin assumption. A premium to the peer median requires specific justification pricing power, scale advantage, or proprietary cost position. [SME] SMEs typically operate at lower margins than large, listed peers due to scale disadvantages. Post-normalization margins should be benchmarked against similar-sized comparable businesses, not large-cap peers. [Project] EBITDA margins for operating projects are typically high and stable, reflecting the low variable cost structure and fixed offtake arrangements. Margin compression arises primarily from cost escalation above contractual limits. [Private Co.] After normalization for owner-managed distortions, benchmark the normalized margin against listed sector peers. Sustained outperformance requires a specific and defensible competitive rationale. [Tech Co.] SaaS businesses typically have high gross margins but significant EBITDA losses at scale due to sales and R&D investment. The path to EBITDA profitability must be explicitly projected with identified cost leverage points. [Other Entity] For regulated businesses, the allowed return framework may effectively cap long-run margins. Projected margins must be consistent with the regulatory framework and not assume returns more than those permitted.
16.	Depreciation and Amortization	Project depreciation and amortization based on the existing asset base, applying the entity's accounting depreciation policy, plus incremental depreciation on projected capital expenditure. D&A is added back in computing EBITDA and in deriving free cash flow but is relevant for computing post-tax EBIT.	Build an asset roll-forward schedule to derive projected D&A. Apply accounting useful lives consistent with applicable financial reporting standards. Confirm that projected D&A is consistent with the capex assumptions in the model.	<i>D&A growing faster than capex implies ghost asset build-up not supported by investment.</i> <i>Applying tax depreciation rates in the financial projections rather than accounting depreciation.</i>	[Listed Co.] Fixed asset schedules in annual accounts provide the basis for projecting opening depreciation. Confirm whether component depreciation applies to heterogeneous asset classes. [SME] Confirm the depreciation policy is consistent with the applicable accounting standards. Restate to accounting useful-life depreciation if tax-purpose accelerated rates have been applied in the books. [Project] Infrastructure assets are depreciated over the concession period or useful life, whichever is shorter. For service concession arrangements, amortization of the intangible concession right may be the relevant charge. [Private Co.] Closely held companies may use accelerated rates for tax purposes. Restate to straight-line or component-based depreciation consistent with accounting standards for valuation purposes. [Tech Co.] Capitalized software development costs should be amortized over their expected useful life typically three to five years. Share-based compensation expense must be separated from cash operating costs. [Other Entity] For intangible-heavy businesses, amortization of acquired intangibles is material and must be reflected in projected EBIT even though it is added back in the FCFF derivation.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Capital Expenditure and Working Capital Assumptions					
17.	Maintenance vs. Growth Capex	Distinguish between maintenance capex (required to sustain existing earning capacity) and growth capex (required to generate projected incremental revenues). Maintenance capex must appear in every year of the model. Growth capex must be directly and explicitly linked to projected incremental revenue.	Obtain the asset register and maintenance schedule to estimate maintenance capex. Map each growth capex item to a specific incremental revenue stream in the model. Include appropriate contingency for construction cost escalation.	<i>Omitting maintenance capex in the outer years of the projection.</i> <i>Projecting revenue growth without the growth capex required to generate it.</i>	[Listed Co.] Management capex guidance from investor communications is the starting point. Validate against historical capex-to-revenue ratios and against sector benchmarks. [SME] Maintenance capex is frequently understated in SME projections. A useful diagnostic: capex-to-depreciation of 0.8x to 1.0x is a minimum check for a steady-state business. [Project] Periodic major overhaul costs for project assets must be modelled as discrete lump-sum items at the appropriate maintenance intervals not smoothed linearly over all the years. [Private Co.] Where management has deferred maintenance investment, the accumulated maintenance backlog must be identified and incorporated into near-term projections. [Tech Co.] Capex for technology businesses is primarily capitalized software development and IT infrastructure. Asset-light business models have minimal traditional physical capex but may have significant software investment. [Other Entity] For real estate developers, construction costs are the dominant capex item. Model by project phase with specific cost assumptions per unit area, adjusted for construction cost escalation.
18.	Working Capital DSO, DIO, DPO	Model net working capital using Days Sales Outstanding for receivables, Days Inventory Outstanding for stock, and Days Payable Outstanding for trade creditors. The change in net working capital from period to period is not the absolute level is the cash flow item in free cash flow.	Compute historical DSO, DIO, and DPO from audited balance sheets. Project changes based on identified operational improvements with supporting evidence. Model the change in NWC as the annual cash flow impacts not the absolute level.	<i>Projecting DPO improvement without supplier contract evidence to support it.</i> <i>Using peak seasonal working capital as the year-end balance for ongoing cash flow purposes.</i>	[Listed Co.] Working capital ratios are derived from published accounts. Benchmark DSO, DIO, and DPO against sector peers and investigate any projected improvement relative to the current position. [SME] SMEs often extend long credit to customers while paying suppliers promptly. This structural gap creates a working capital funding requirement that must be explicitly modelled in FCFF. [Project] Working capital for project entities is typically minimal. The primary item is the debt service reserve account balance, which is a restricted financial asset treated separately from operating NWC. [Private Co.] Related-party receivables and payables should be excluded from operating working capital and treated as financial items equivalent to debt or equity depending on their nature. [Tech Co.] SaaS businesses often have negative working capital deferred revenue from annual subscriptions paid upfront exceeds trade receivables. As ARR grows, this creates a working capital benefit that inflates early-year FCFF. [Other Entity] For seasonal businesses, use normalized year-end working capital rather than the seasonal peak. Model the peak funding requirement separately for liquidity and debt-sizing analysis.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Tax Assumptions					
19.	Effective Tax Rate	Apply the effective tax rate not the statutory corporate tax rate based on historical analysis adjusted for known future changes. Reconcile the difference between the statutory and effective rates through deferred tax movements, non-deductible expenses, tax credits, and applicable exemptions.	Reconcile the historical effective rate to the statutory rate line by line. Model the future effective rate based on the expected expiry of exemptions and changes in legislation. Confirm deferred tax treatment is internally consistent with the cash flow projections.	<i>Mechanically applying the statutory rate without considering applicable exemptions or structural non-deductibles.</i> <i>Projecting an effective rate below the statutory rate indefinitely without identifying the source of the divergence.</i>	[Listed Co.] Tax disclosures in audited accounts provide a reconciliation of effective to statutory tax rate. Review these disclosures to identify the key sources of divergence and their expected continuity. [SME] SMEs may benefit from concessional tax regimes available for smaller businesses under applicable tax legislation. Confirm eligibility, applicable rate, and any conditions or thresholds. [Project] Infrastructure projects frequently benefit from tax holidays or reduced rate periods. Model the period of eligibility precisely and reflect the transition to the full statutory rate at the end of the concession period. [Private Co.] Private companies may have accumulated tax losses carried forward from prior periods. Build a detailed loss utilization schedule based on the applicable carry-forward period under local tax legislation. [Tech Co.] Start-ups recognized by the relevant authority may benefit from tax holiday provisions under the applicable incentive regime. Model the election, applicable period, and the impact of expiry on the tax rate. [Other Entity] For entities with exempt income (trusts, cooperatives with special status), confirm the scope and conditions of the exemption. Any breach of conditions may result in full tax liability retrospectively.
20.	Tax Concessions, Incentives, and Expiry	Identify and model all applicable tax concessions sector-specific incentives, investment allowances, accelerated depreciation, and export incentives with their precise quantum, duration, and expiry. The transition to the full statutory tax rate at the end of a concession period must be explicitly modelled.	Verify eligibility for each concession with a tax advisor. Model the exact expiry date of each concession. Conduct sensitivity analysis on the value impact of early concession termination.	<i>Extending a concession beyond its legally prescribed period.</i> <i>Failing to model the tax rate step-up at concession expiry this can be a material change in free cash flow.</i>	[Listed Co.] Tax concession notes in audited accounts provide the basis. Confirm that the treatment in the projections is consistent with the remaining eligible period. [SME] Concessional tax rates for small and medium businesses may be subject to revenue or asset size thresholds. Confirm that projected growth does not breach the threshold and trigger the standard rate. [Project] Power generation, road, and port projects commonly enjoy multi-year tax holidays. The expiry of the holiday and the transition to full taxation is one of the largest single-year impacts on project free cash flow. [Private Co.] Private companies that have relied on tax incentives should be stress-tested on the assumption that the incentive is not renewed both for risk disclosure and for downside scenario purposes. [Tech Co.] Technology sector incentives (R&D tax credits, start-up tax holidays, export software incentives) vary by jurisdiction. Confirm the specific provisions and their eligibility conditions for the subject entity. [Other Entity] For entities in special economic zones or designated investment areas, confirm that the zone designation and associated incentives remain in force and are not subject to cancellation.



Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
21.	Tax on EBIT vs. Tax Shield on Debt	In the FCFF/WACC framework, the tax shield on interest is captured entirely in the after-tax cost of debt within the WACC formula. It must not be separately deducted from FCFF. FCFF is computed as EBIT multiplied by one minus the effective tax rate not as net profit adjusted.	Confirm FCFF starts from EBIT, not from net profit or profit before tax. Verify that the tax shield is reflected only in the after-tax cost of debt in WACC. Document the methodology in the report to enable independent verification.	<i>Double counting the interest tax shield by including it in both the cash flows and the WACC.</i> <i>Computing FCFF by starting from net profit and adding back interest this produces the same double-counting error.</i>	[Listed Co.] This error is more common than it appears. Reconcile the FCFF derivation back to the income statement to confirm no double-counting of the debt tax benefit. [SME] SMEs with high leverage are particularly prone to this error the interest deduction is large and its inclusion in FCFF would materially overstate value. [Project] Project finance structures with significant debt make this distinction critical. FCFF should be calculated on an unlevered basis and discounted at WACC, which captures the debt tax shield. [Private Co.] In closely held companies where the valuer constructs the model from the ground up, ensure the FCFF formula is correctly specified from the outset. [Tech Co.] For equity-funded tech companies with no debt, the issue is moot. However, for companies with venture debt or convertible instruments, confirm the treatment before building the model. [Other Entity] For any entity where the applicable accounting framework does not produce a clear EBIT line, reconstruct EBIT from reported revenues and operating costs before applying the FCFF formula.
Discount Rate (WACC) Assumptions					
22.	Capital Structure Weights	Use target or optimal long-run capital structure weights, not current book-value weights. Estimate the target debt-to-equity ratio by reference to the sector's observed leverage norms and, where available, the subject company's stated financing policy.	Use market value weights, not book value weights. Benchmark target D/E against listed sector comparables. Confirm the target leverage is achievable and consistent with projected debt service coverage.	<i>Using book-value debt and book-value equity as WACC weights.</i> <i>Applying a zero-debt structure to a business that is operationally leveraged.</i>	[Listed Co.] Market capitalization provides equity weight. Use the market value of total financial debt. Compare the implied target D/E against the company's historical leverage trend. [SME] SMEs are often over-levered relative to sector norms. Normalize to a sustainable target D/E using the current distressed capital structure that inflates WACC and understates value. [Project] Project finance structures typically prescribe the D/E ratio contractually. Use the contracted financial structure as the capital structure input in WACC. [Private Co.] The capital structure of private companies often reflects promoter preferences rather than an optimized financial policy. Benchmark against listed peers for a market-consistent target weight. [Tech Co.] High-growth technology companies are typically equity-funded. Post-profitability, modest leverage may be appropriate. If the capital structure is expected to change materially over the horizon, model the transition in WACC. [Other Entity] For regulated utilities, the regulator may prescribe the capital structure in the tariff order. Use this as the WACC input the regulatory structure represents the target by definition.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
23.	Risk-Free Rate	Use the yield on long-dated government bonds as the risk-free rate, matching the currency of the projected cash flows. The bond maturity should approximate the duration of the projected cash flow typically a ten-year benchmark. Use the rate prevailing as of the valuation date from a credible published source.	Cite the published source and date of the risk-free rate. Match the bond maturity to the forecast horizon. Use the nominal rate for nominal cash flow models; convert to real if projections are in real terms.	<i>Using bank deposit or interbank lending rates as a proxy for the risk-free rate.</i> <i>Applying a risk-free rate from a materially different date than the valuation date.</i>	[Listed Co.] Central bank or debt management office publications are the primary source for government bond yields. Use the secondary market yield for the on-the-run ten-year benchmark as of the valuation date. [SME] The same government bond benchmark applies. Additional risk for smaller companies is captured through size and company-specific risk premiums not through adjusting the risk-free rate. [Project] For long-duration infrastructure projects with twenty-five to thirty year concessions, a longer-tenor government bond may be more appropriate. Interpolate between available tenors if a specific maturity is not traded. [Private Co.] Standard ten-year government bond benchmark. Confirm consistency of date across all WACC components. [Tech Co.] Same government bond benchmark for domestic currency models. For cross-border or USD-denominated valuations, use the risk-free rate in the currency of the cash flows and adjust for country risk separately. [Other Entity] For foreign-currency-denominated cash flows, use the risk-free rate in the relevant currency and add an appropriate sovereign spread to reflect local country risk.
24.	Equity Risk Premium	The Equity Risk Premium represents the additional return demanded by equity investors above the risk-free rate. Use an implied ERP derived from current market pricing of equities relative to risk-free rates, or a long-run historical ERP from a robust data series. Disclose the source, date, and basis (implied vs. historical; arithmetic vs. geometric) of the ERP used.	Use implied ERP (preferred) or long-run historical ERP with consistent methodology. Ensure the ERP and risk-free rate are drawn from the same date. Disclose source, date, and computation basis explicitly in the report.	<i>Using arithmetic mean ERP without disclosure the arithmetic mean consistently overstates the forward-looking ERP.</i> <i>Mixing ERPs from different jurisdictions or different dates without adjustment.</i>	[Listed Co.] Published implied ERP estimates updated annually are the preferred reference. The publicly available academic sources provide country-level implied ERPs updated regularly. [SME] The same base ERP applies. Entity-level risk for smaller businesses is captured through size and company-specific risk premiums not through an inflated ERP input. [Project] Use the same base market ERP. Project-specific risks are reflected in the company-specific risk premium or captured through scenario analysis, not by adjusting the base ERP. [Private Co.] Apply the applicable market ERP. Key-person risk, customer concentration, and other entity-level risks are addressed through the company specific risk premium (CSRP) component not the ERP. [Tech Co.] For early-stage venture-backed entities, cross-check CAPM-derived cost of equity against venture capital expected return benchmarks as a reasonableness check. [Other Entity] For government-owned entities operating under cost-of-service regulation, the ERP input into the allowed return computation may be prescribed or bounded by the regulator.



Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
25.	Beta	For privately held companies, derive beta by (i) selecting listed proxy companies with similar business risk, (ii) un-levering their observed equity betas to derive asset betas using the applicable formula, (iii) computing a representative asset beta (median of the proxy set), and (iv) re-levering using the subject's target capital structure.	Use a minimum of five to eight proxy companies for statistical validity. Report the median asset beta this is robust to outliers. Re-lever using the target D/E ratio and the subject's effective tax rate.	<i>Using a single proxy company beta.</i> <i>Applying the levered beta of proxy companies directly ignores capital structure differences between the proxies and the subject.</i>	[Listed Co.] Listed companies have observable equity betas from exchange data. Use two-year or five-year weekly return betas. Apply a mean-reversion adjustment to reduce the influence of temporary market conditions. [SME] No directly observable beta. Use unlisted proxies from the listed peer set, adjusted for size. The asset beta of smaller companies may be somewhat higher due to greater earnings volatility. [Project] Use sector-specific proxy betas from listed infrastructure companies in the relevant sub-sector. Infrastructure asset betas are typically lower than the broad market, reflecting contracted revenues and stable cash flows. [Private Co.] Build the proxy set from sector-comparable listed companies. Weight proxies by business model similarity. Document the overlap between each proxy's business and the subject. [Tech Co.] For technology companies, use listed tech comparables in the relevant sub-sector. Where local listed proxies are insufficient, global listed peers with similar business models may be used with appropriate disclosure. [Other Entity] For conglomerates or holding companies, compute a weighted asset beta across the underlying business segments, weighted by each segment's estimated enterprise value.
26.	Cost of Debt	Use the current market borrowing rate for the entity based on its credit profile and prevailing sector lending norms not the embedded historical rate on existing facilities. The after-tax cost of debt is computed as the pre-tax rate multiplied by one minus the effective tax rate.	Obtain current lending rates from the entity's bank or reference sector benchmarks. Confirm the after-tax treatment is consistent with the effective tax rate in the model. Do not double-count the tax shield it is captured only in the after-tax cost of debt in WACC.	<i>Using the average historical interest rate from the income statement as the current cost of debt.</i> <i>Failing to convert the cost of debt to an after-tax basis.</i>	[Listed Co.] Rated entities have market-observable costs of debt from publicly issued bonds or credit facility disclosures. For unrated companies, reference comparable-rated peers' borrowing rates. [SME] SME borrowing costs are typically set at a reference rate plus a credit spread. Use the prevailing reference rate as of the valuation date plus an appropriate spread for the entity's credit profile. [Project] Project finance from development finance institutions is often at concessional rates. Use the blended rate of the actual financing mix concessional and commercial as the cost of debt. [Private Co.] Related-party or promoter loans at non-market rates must be adjusted to market-rate equivalents in the WACC computation. Non-arm's-length debt is not a valid cost of debt benchmark. [Tech Co.] Equity-funded early-stage companies effectively have no debt. WACC equals the cost of equity. Where venture debt exists, use its contractual rate. Where convertible instruments exist, bifurcate into debt and equity components. [Other Entity] For issuers of listed debt securities, the current yield to maturity on outstanding instruments is the most direct market-based estimate of the current cost of debt.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Terminal Value Assumptions					
27.	Terminal Growth Rate	The perpetuity growth rate must not exceed the long-run nominal GDP growth rate of the economy in which the business predominantly operates. It must be internally consistent with the reinvestment rate and return on invested capital in the terminal year: $g = ROIC \times \text{Reinvestment Rate}$.	Benchmark terminal growth against the long-run nominal GDP growth of the relevant economy. Compute the implied reinvestment rate from the terminal growth rate and ROIC. Sensitize the concluded value against a range of terminal growth rate assumptions.	<i>Applying a terminal growth rate above nominal GDP growth is mathematically unsustainable in perpetuity.</i> <i>Using real GDP growth as the terminal rate when the model is built on nominal assumptions.</i>	[Listed Co.] For large diversified listed companies, a terminal growth rate broadly aligned with long-run nominal GDP is appropriate. Sector leaders with sustained competitive advantages may justify the upper end of the defensible range. [SME] Apply a conservative terminal growth rate reflecting higher execution risk and the expectation that competitive forces will erode above-average returns as the business matures over time. [Project] Where the concession or contract expires without renewal, the perpetuity terminal growth rate is not applicable. Use residual asset value or zero terminal growth in such cases. [Private Co.] A terminal growth rate in line with the long-run economy is standard. Businesses in highly competitive or commoditized industries should use the lower end of the defensible range. [Tech Co.] Companies entering a mature phase should use a terminal growth rate consistent with the broader economy. For companies still in a high-growth phase at end of explicit period, use a time-bound model rather than a perpetuity. [Other Entity] For cyclical businesses, terminal growth should be based on mid-cycle normalized cash flows not extrapolated from peak or trough conditions prevailing at the end of the explicit forecast period.
28.	Normalized Terminal Year Free Cash Flow	The free cash flow used as the input to the terminal value calculation must represent a sustainable, normalized steady-state level. The terminal year must reflect a stable EBITDA margin at the industry equilibrium, maintenance capex approximately equal to depreciation, a full statutory tax rate, and normalized working capital movement.	Confirm the last explicit year is truly at a normalized steady state. Insert a transitional year if the last explicit year still reflects growth-phase capex or temporary margin conditions. Apply the full statutory tax rate unless a confirmed long-term concession extends beyond the explicit period.	<i>Using an inflated final-year FCFF driven by a transient capex trough or temporary margin peak as the terminal value base.</i> <i>Applying a concessional tax rate in the terminal year after the concession has expired.</i>	[Listed Co.] The terminal year's margin should reflect the long-run sector equilibrium observable from peer data not the company's peak projected margin. [SME] Normalize the terminal year for any remaining one-off items. Confirm that maintenance capex is adequate to sustain earning capacity. [Project] For fixed-term projects, terminal value may be based on residual asset value rather than a going-concern perpetuity. Asset salvage value and land or facility reversion rights drive the terminal value. [Private Co.] Confirm that owner compensation in the terminal year is at market rate neither inflated nor deflated by the owner-managed nature of the business. [Tech Co.] The terminal year should reflect a mature business with stable margins, moderate growth, and R&D costs at maintenance levels. The Rule of 40 is a useful sanity check for the terminal SaaS business profile. [Other Entity] For seasonal businesses, the terminal FCF should be based on the normalized annual average not the year-end snapshot, which may reflect a seasonal high or low.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
29.	Terminal Value as a Proportion of Enterprise Value	Monitor the share of total enterprise value attributable to the terminal value. If terminal value exceeds seventy to seventy-five percent of total EV, the reliability of near-term projections and the assumptions of the terminal year warrant additional scrutiny and extended sensitivity testing.	Compute the terminal value to total enterprise value ratio in the model. Investigate and explain if terminal value exceeds 70% of total EV. Consider extending the explicit forecast period if the terminal value share is disproportionately high.	<i>Mechanically accepting a model where terminal value represents 90% or more of EV without scrutiny.</i> <i>Using a short explicit forecast period that artificially inflates the terminal value contribution.</i>	[Listed Co.] For large stable businesses, a TV share of 55–70% is typical. Beyond 75%, the sensitivity analysis around terminal growth rate and WACC becomes the dominant driver of the concluded range. [SME] For SMEs with a short and less reliable forecast period, the TV share may be high. This amplifies the importance of the terminal growth rate assumption and requires robust sensitivity disclosure. [Project] For projects where cash flows are entirely front-loaded in the concession period, the TV share may be low or zero. The converse late cash flow concentration warrants scrutiny of construction or ramp-up assumptions. [Private Co.] A very high TV share (above 80%) for a private company may signal that near-term projections are excessively conservative or that the terminal assumptions need review. [Tech Co.] For high-growth tech companies, TV shares of 80–90% are common due to the compressed near-term free cash flows. This is acceptable if assumptions are well-substantiated and sensitivity-tested extensively. [Other Entity] For businesses with defined-life concessions or contracts, TV share will naturally fall as the contract expiry approaches. Confirm terminal value is consistent with the contractual situation at end of period.

The Market Approach to Valuation

6.1 Overview and Suitability

The Market Approach estimates the value of a business or asset by comparing it with similar entities or transactions in the market. It is based on the principle that an informed buyer would not pay more for an asset than the price paid for a comparable one. This approach is particularly effective when there are sufficient market-based data points, such as public company multiples or recent transactions involving comparable assets or companies.

It is best suited for:

- Valuing minority or majority equity interests
- Businesses operating in established industries with active markets
- Benchmarking against industry peers or precedent transactions

The two most commonly used methods under this approach are Comparable Company Analysis (CCA) & Precedent Transactions Analysis (PTA).

6.2 Comparable Company Analysis (CCA)

Comparable Company Analysis (CCA), also referred to as the Guideline Public Company Method—is a widely used market-based valuation approach. It involves valuing a subject company by benchmarking it against publicly traded companies that are similar in terms of industry, size, growth profile, and financial characteristics. The underlying principle is that similar businesses should command similar valuation multiples in efficient markets.

This method is particularly useful when valuing private companies, as it provides market-based benchmarks derived from observable trading data of listed entities.

Methodology Overview

The process of Comparable Company Analysis involves the following key steps:

- Identification of Comparable Companies:** Companies selected should operate in the same or closely related industry and share similarities in business model, revenue streams, growth trajectory, capital structure, and risk profile.
- Data Collection and Financial Standardization:** Key financial metrics are gathered from reliable sources (e.g., annual reports, financial databases) and adjusted for consistency. Non-recurring items, one-time gains/losses, or accounting policy differences are normalized.
- Selection of Valuation Multiples:** Commonly used trading multiples include:
EV / EBITDA: Enterprise value relative to earnings before interest, tax, depreciation, and amortization.



EV / EBIT: For businesses with consistent capital structures and lower depreciation impact.

P / E Ratio: Price to earnings, useful for equity valuation.

EV / Sales: Applied where earnings are volatile or negative, often in startups or early-stage companies.

- d. Adjustment and Application of Multiples:** The selected multiples are adjusted for differences in size, growth, or risk (e.g., illiquidity, private status), and then applied to the subject company's relevant financial metric (e.g., EBITDA, net income) to estimate its value.

Example:

A private company generates EBITDA of NPR 20 million. After identifying three comparable listed companies with EV/EBITDA multiples of 8.5x, 9.0x, and 8.2x, a normalized multiple of 8.6x is chosen. The implied enterprise value is:

Enterprise Value = $20,000,000 \times 8.6 = \text{NPR}172,000,000$

After adjusting for debt and surplus cash, the equity value of the company is derived.

CCA is widely used due to its market-based nature, though it requires careful selection of truly comparable companies and appropriate adjustments for differences in size, growth, and risk profile.

6.3 Market Price Method

The Market Price Method is one of the most direct and objective valuation techniques under the Market Approach. It determines the fair value of an equity instrument or security based on its quoted price in an active and orderly market as of the valuation date. This method reflects Level 1 input under NFRS 13 – Fair Value Measurement, as it relies on observable market prices without adjustment.

This method is most applicable when valuing listed equity shares, publicly traded bonds, or any other security actively traded on a recognized stock exchange.

This method may be applied only when the following conditions are met:

- The shares or securities are frequently traded on a recognized stock exchange in Nepal or internationally.
- The market is active, and the trading volumes are sufficient to ensure price discovery.
- The prices used are as of the valuation date (or within a reasonable window around it).
- There are no restrictions on the transferability or trading of the securities (e.g., lock-in periods, insider holdings).

Methodology

Step 1: Identify the Valuation Date

The specific date as of which the fair value is to be determined.

Step 2: Determine the Market Price

Identify the closing price or volume-weighted average price (VWAP) of the security on the valuation date. In case of high volatility, a weighted average over a reasonable historical window (e.g., 15 or 30 trading days) may be used to smooth out anomalies.

Step 3: Adjust for Liquidity or Marketability (if necessary)

If the subject holding is not freely tradable (e.g., large block, thinly traded stock, or subject to lock-in), a discount for lack of marketability (DLOM) may be applied, based on professional judgment or market studies.

Example:

An entity holds 1,00,000 shares of XYZ Ltd., a company listed on the Nepal Stock Exchange (NEPSE). The closing share prices over the 15 days preceding the valuation date (January 1, 2025) ranged between NPR 520 and NPR 580. The VWAP over the 15 days is NPR 550.

Assuming the shares are freely traded and actively traded, the fair value under the Market Price Method is:

$$100,000 \text{ shares} \times \text{NPR } 550 = \text{NPR } 55,000,000$$

If the shares are subject to a 12-month lock-in, a 10% discount for lack of marketability may be applied:

$$\text{NPR } 55,000,000 \times (1 - 0.10) = \text{NPR } 49,500,000$$

6.4 Precedent Transactions Analysis (PTA)

Precedent Transactions Analysis (PTA), also known as the Guideline Transaction Method, is a market-based valuation technique that derives value by analyzing the pricing multiples paid for in recent, comparable mergers or acquisitions. The core premise is that the value of a company can be inferred from actual transaction prices paid for similar businesses under similar circumstances.

This method is particularly relevant in contexts involving change of control, such as mergers, acquisitions, private equity exits, or regulatory valuations.

Methodology Overview

- a. Identification of Comparable Transactions:** Select historical transactions involving companies in the same or closely related industry, with similar scale, business model, and transaction structure (e.g., controlling interest vs. minority stake).
- b. Gathering Transaction Data:** Obtain relevant deal information including transaction value (purchase price), financial metrics at the time of acquisition (e.g., EBITDA, revenue, net income) and deal terms (e.g., cash vs. stock, control premium, synergies).

Sources may include regulatory filings, press releases, publicly available databases and public disclosures.



- c. **Calculation of Implied Multiples:** Common valuation multiples used in PTA include EV/EBITDA, EV/Revenue and Price/Earnings (P/E). These multiples are computed based on the target's financials at the time of the transaction.
- d. **Adjustment and Application to Subject Company:** After selecting a reasonable range of multiples, appropriate adjustments are made for differences in growth, risk, market conditions, and synergies. The adjusted multiples are then applied to the subject company's current financials to estimate its value.

Example:

Assume recent acquisitions in the industry occurred at EV/EBITDA multiples of 9.0x, 9.8x, and 10.5x. After normalizing outliers and terms of deal structure, a multiple of 9.5x is adopted. For a company with EBITDA of NPR 20 million:

$$\text{Enterprise Value} = 20,000,000 \times 9.5 = \text{NPR } 190,000,000$$

PTA often results in higher valuation outcomes due to the inclusion of synergies and control premiums. However, limited availability of detailed transaction data, especially in private markets, can limit its applicability in certain contexts.

6.5 Selection of Comparable Companies

The effectiveness of both Comparable Company Analysis (CCA) and Precedent Transactions Analysis (PTA) depends heavily on the selection of appropriate comparable. The closer the match between the subject company and the selected peer group, the more reliable and meaningful the valuation outcome. Key criteria for selecting comparable companies or transactions:

- a. **Industry and Business Model:** The company should operate in a similar sector with comparable products, services, and revenue streams. Differences in market positioning or customer base may warrant adjustments.
- b. **Size and Scale:** Comparable companies should be similar in terms of revenue, EBITDA, assets, or number of employees. Size affects bargaining power, economies of scale, and ultimately valuation multiples.
- c. **Growth and Profitability:** Similar growth outlooks and profit margins ensure that the multiples are reflective of comparable risk-return expectations. For instance, a company with high revenue growth and margin expansion may justify higher multiples.
- d. **Geographic Presence:** Location influences cost structures, regulatory environment, and access to markets. Companies operating in different countries may have fundamentally different risk profiles and valuation benchmarks.
- e. **Capital Structure:** A similar leverage profile ensures consistency in comparing enterprise values or equity multiples. Highly leveraged firms may trade at lower multiples due to increased financial risk.

Proper selection of comparable is foundational to the credibility of a market-based valuation. If perfect comparable are not available, the valuer must apply adjustments or consider triangulating with income or asset-based approaches for validation.

6.6 Adjustment for Differences

When applying market multiples from comparable companies or transactions, it is essential to adjust for differences between the subject company and the comparable. These differences may relate to size, growth potential, risk profile, profitability, capital structure, or geographic presence. For example:

- Larger firms may command higher valuation multiples due to economies of scale and market influence. If the subject company is smaller, a discount to the observed multiple may be warranted.
- Companies with higher growth rates or superior margins usually trade at higher multiples. Adjustments may be required if the subject's financial performance deviates from the peer average.
- Differences in operating risk, customer concentration, regulatory exposure, or cyclicalities must be considered. A company with higher operational or financial risk may justify a lower multiple.
- IFRS-compliant financials may differ from local GAAP in the case of foreign comparable. Ensure consistency in the calculation of metrics like EBITDA or book value.

Example:

If the average EV/EBITDA multiple of comparable is 8.6x, but the subject company has lower margins and higher volatility, a downward adjustment to 8.0x may be justified. The adjusted enterprise value, using EBITDA of NPR 20 million, becomes:

$$\text{Enterprise Value} = 20,000,000 \times 8.0 = \text{NPR } 160,000,000$$

Such adjustments must be documented and based on logical, supportable criteria.

6.7 Market Multiples (P/E, EV/EBITDA, etc.)

Market multiples are at the core of the market approach. These are ratios derived from the market value of comparable companies or transactions relative to their financial metrics. Common Multiples and their use cases are:

- Price-to-Earnings (P/E):** Used for equity valuation, especially when earnings are stable. Not suitable if earnings are volatile or negative.
- Enterprise Value to EBITDA (EV/EBITDA):** Widely used for company-level valuation as it neutralizes capital structure and tax impacts. Suitable for comparing across companies and industries.
- Enterprise Value to Sales (EV/Sales):** Used when earnings are not meaningful (e.g., in startups or loss-making entities). Caution is required as sales alone may not reflect value.
- Price-to-Book (P/BV):** Common in financial institutions or asset-heavy businesses. Effective when assets are fairly stated on the balance sheet.

Example Comparison:

Metric	Value (NPR)	Selected Multiple	Implied Value (NPR)
EBITDA	20,000,000	8.6x	172,000,000
Net Income	12,000,000	15x (P/E)	180,000,000
Revenue	100,000,000	2.0x (EV/Sales)	200,000,000



Multiples should be triangulated, and preference given to those most relevant for industry and data availability. Similarly, in case of regulated industry like Bank and Financial Institutions, Insurance Company regulator prescribed valuation multiple (if any) should be considered with prescribed weightage.

6.8 Limitations of Market-Based Valuations

While the Market Approach is intuitive and grounded in actual market behavior, it is not without its challenges and limitations:

- **Lack of Truly Comparable Companies or Transactions:** Especially in the context of private companies in Nepal, identifying peers with similar scale, risk, and financial structure may be difficult.
- **Non-Uniform Financial Data:** Differences in accounting policies or incomplete disclosures may distort key metrics such as EBITDA or net income, affecting the reliability of the multiples.
- **Market Conditions May Not Reflect Intrinsic Value:** During market booms or downturns, pricing may deviate from fundamental value. Blind reliance on such data can mislead valuations.
- **Premiums and Discounts:** Multiples derived from public markets reflect minority, liquid interests. Adjustments are needed when valuing controlling or illiquid stakes, but estimating such adjustments introduces subjectivity.
- **Limited Transaction Transparency:** Precedent Transactions Analysis often suffers from lack of detailed disclosures, especially in private deals, limiting comparability.

Despite these limitations, the Market Approach remains a valuable tool when sufficient, relevant, and recent data is available. It is often used alongside the Income and Asset-Based Approaches to validate results and triangulate a defensible value conclusion.

6.9 Comparable Companies Multiple Method (CCMM)

The Comparable Companies Multiple Method (CCMM) is a specific application of the market approach that derives value by applying financial multiples observed from a peer group of publicly traded or privately transacted comparable companies to the corresponding financial metrics of the subject company. While Comparable Company Analysis (CCA) and Precedent Transactions Analysis (PTA) are broad frameworks, the CCMM provides a disciplined, structured methodology for selecting, adjusting, and applying those multiples in a manner that is directly defensible and replicable – and is particularly important in regulatory, litigation, and reporting contexts where methodological rigor is paramount.

Distinction from CCA and PTA:

CCA is the broad analytical process of identifying and screening comparable listed peers; PTA focuses on historical M&A transaction multiples. The CCMM is the specific valuation technique that formalizes the multiple-selection and application step into a structured, auditable process. It may draw on multiples from both CCA and PTA peer sets, or exclusively from publicly traded comparables, depending on data availability and the purpose of the valuation.

Methodology:**Step 1 – Universe Definition:**

Define the criteria for selecting the comparable universe typically industry classification (e.g., NEPSE sector or international Global Industry Classification Standard code), business model similarity, revenue scale, geographic focus, and growth profile. The initial universe may be broad; screening then narrows it to the most relevant peers.

Step 2 – Multiple Selection:

Identify the most meaningful multiple(s) for the subject entity's industry and stage. Common multiples include EV/EBITDA (capital-structure neutral, widely used for operating companies), EV/EBIT (for capital-light or low-depreciation businesses), P/E (for stable, profitable entities), EV/Revenue (for high-growth or pre-profit businesses), and P/BV (for financial institutions and asset-heavy businesses). The selected multiple(s) should be those on which market participants focus when pricing transactions in the relevant sector.

Step 3 – Normalization:

Adjust both comparable and subject financial metrics for non-recurring items, accounting policy differences (e.g., treatment of leases under IFRS 16 / NFRS 16), extraordinary gains or losses, and differences in depreciation or amortization policies. The aim is to arrive at a "clean" earnings or EBITDA figure that is comparable across entities on a like-for-like basis.

Step 4- Derivation of the Reference Multiple: From the peer group, calculate the central tendency of the observed multiple typically the median (preferred over the mean as it is less distorted by outliers) and the interquartile range. Outlier multiples, whether caused by atypical company-specific events, pending M&A activity, or illiquidity, should be identified and either excluded or separately considered. The reference multiple is typically selected within the range established by the peer median and the nature of the subject company's relative characteristics.

Step 5-Adjustment for Subject-Specific Factors: Apply qualitative or quantitative adjustments to the reference multiple to reflect differences between the comparable group and the subject company. Relevant adjustment factors include:

- a. size – smaller companies typically command lower multiples due to higher risk, lower liquidity, and reduced access to capital;
- b. growth – a company with superior revenue or earnings growth may justify a premium to the peer median;
- c. profitability and margin – EBITDA margin differentials directly affect the appropriate EV/EBITDA multiple;
- d. leverage – higher financial leverage increases equity risk and may depress multiples; and
- e. marketability – for private company subjects, a Discount for Lack of Marketability (DLOM) should be applied to account for the illiquidity of unlisted securities.

Step 6 – Application and Value Derivation:

Apply the adjusted multiple to the subject company's relevant financial metric (e.g., Last Twelve Month (LTM) EBITDA, forward EBITDA, or net income) to derive an enterprise value or equity value. Where an enterprise value multiple is used, deduct net debt (and add surplus assets, if applicable) to arrive at equity value. The CCMM typically yields a valuation range rather than a single point estimate, reflecting the spread of observed multiples in the peer group.

Illustrative Example:

A manufacturing company in Nepal reports LTM EBITDA of NPR 50 million and net debt of NPR 80 million. Five comparable listed peers trade at EV/EBITDA multiples of 6.5x, 7.0x, 7.2x, 7.5x, and 8.0x, giving a peer median of 7.2x. After applying a 10% downward adjustment for the subject company's smaller scale and a 15% DLOM for lack of marketability, the adjusted multiple is $7.2x \times (1 - 10\%) \times (1 - 15\%) = \text{approximately } 5.5x$. Enterprise Value = NPR 50 million $\times 5.5x$ = NPR 275 million. Equity Value = NPR 275 million – NPR 80 million = NPR 195 million.

The CCMM is valued for its transparency and market grounding, but practitioners must resist the temptation to cherry-pick multiples that support a predetermined conclusion. The entire selection and adjustment process must be documented, and any exclusions from the peer universe must be explained and justified. In the Nepalese context, where the pool of listed comparable companies on NEPSE may be limited, international peer groups – appropriately adjusted for country risk and market differences – may supplement or substitute for local comparables, provided the adjustments are clearly disclosed.

6.10 Conclusion

The Market Approach offers a practical and externally benchmarked perspective to valuation by leveraging observed market data from comparable companies and transactions. It is particularly useful when reliable public or transactional data is available, and when the subject business operates in a reasonably active and comparable market environment.

Comparable Company Analysis (CCA) provides insights based on current market expectations, while Precedent Transactions Analysis (PTA) reflects actual deal values, often incorporating control premiums and real-world negotiation dynamics. Both methods require careful selection of comparable, normalization of financial metrics, and judgment-based adjustments to reflect the specific characteristics of the subject entity.

While the Market Approach may not always be feasible in thinly traded or highly specialized markets like Nepal, it serves as a critical cross-check against income- and asset-based methods, and supports fairness, transparency, and regulatory compliance in valuation practice.

Practice Notes: Market Approach (Comparable Company and Comparable Transaction Methods)

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Comparable Company Method (Trading Multiples)					
	Comparable Company Selection Criteria	Select publicly listed comparables based on similarity across business models, industry, geographic market, revenue scale, growth profile, profitability, and capital structure. A minimum of five to eight comparables is required for statistical robustness. Document the basis for including or excluding each candidate.	Build a screening matrix to document inclusion and exclusion rationale. Identify pure-play comparables; use SOTP comparables for conglomerates. Review the comparable set at least annually business profiles change.	<i>Selecting comparables by industry code alone without assessing business model similarity.</i> <i>Retaining outliers distorted by M&A speculation or temporary corporate events.</i>	[Listed Co.] Stock exchange data provides a full universe of listed companies by sector. Sector indices define a natural starting universe. Apply business model and financial profile screens to narrow to the most relevant comparables. [SME] Pure-play listed SME comparables may not exist. Use the closest large-cap listed peers and apply an explicit size adjustment. SME-exchange-listed companies, where available, may provide size-proximate references. [Project] Use listed infrastructure companies in the same sub-sector. For early-stage projects, traded project bonds or listed infrastructure funds may provide additional reference yields and valuation benchmarks. [Private Co.] Same listed peer universe as for SME. Supplement with private transaction databases for deal-level pricing evidence. [Tech Co.] Use listed technology companies in the relevant sub-sector. For businesses without adequate listed local proxies, global listed peers with similar business models are acceptable with appropriate country risk disclosure. [Other Entity] For diversified financial services or holding companies, use segment-level listed comparables for each underlying business and apply SOTP methodology rather than a consolidated multiple.
	Multiple Selection by Business Type	The appropriate valuation multiple depends on the business's profitability stage, sector, and capital intensity. EV/EBITDA is the most widely applicable enterprise multiple. Sector-specific multiples include price-to-book for financial institutions, EV per unit of capacity for infrastructure, and EV/ARR for subscription-based technology businesses.	Confirm the chosen multiple is meaningful, do not apply EV/EBITDA when EBITDA is negative. Use both trailing and forward multiples and compare the implied growth. Apply enterprise value multiples where capital structures differ materially across the comparable set	<i>Applying EV/EBITDA when EBITDA is negative the result is meaningless.</i> <i>Mixing trailing and forward multiples across comparables without disclosure.</i>	[Listed Co.] EV/EBITDA and price/earnings are standard for industrial and consumer companies. Price-to-book for financial institutions. Use forward multiples based on consensus analyst estimates where available. [SME] EV/EBITDA is preferred. For businesses where EBITDA is unstable or negative, EV/Revenue may be more meaningful. Confirm EBITDA is positive before applying an EBITDA multiple. [Project] EV/EBITDA is the primary multiple. Sub-sector capacity multiples (e.g., EV per MW for power, EV per km for roads) provide a useful cross-check anchored in physical operating parameters. [Private Co.] EV/EBITDA is primary. EV/Revenue as a secondary measure for pre-EBITDA entities. For service businesses, EV/Revenue or EV/gross profit may be more stable than EV/EBITDA. [Tech Co.] Pre-revenue: EV/gross merchandise value. Early stage: EV/Revenue or EV/ARR. Profitable stage: EV/EBITDA. Loss-making: EV/Revenue with reference to gross margin and growth rate together. [Other Entity] For renewable energy assets, EV/MW and EV/EBITDA are standard. For hospitality, EV per room key and EV/EBITDA. For retail, EV per unit area and EV/EBITDA.



Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Normalization of Comparable Company Financials	Normalize the financial metrics of comparable companies for non-recurring items before computing the multiple. This is symmetrical with the normalization applied to the subject company. Mixing normalized subject metrics with as-reported comparable metrics creates a systematic and directional valuation error.	Review each comparable company's most recent accounts for non-recurring items. Apply the same normalization principles to both the subject and the comparables. Document all adjustments made to comparable metrics.	<i>Using as-reported EBITDA for comparables but normalized EBITDA for the subject.</i> <i>Failing to remove acquisition-related costs or impairment charges from comparable earnings.</i>	[Listed Co.] The most common normalization for listed comparables: share-based compensation (non-cash), restructuring charges, and amortization of acquired intangibles from business combinations. [SME] SME-exchange-listed comparables may have limited financial disclosure. Normalize on a best-effort basis and note any limitations. [Project] For comparable project companies, normalize for commissioning-period losses, construction-phase interest capitalization, and any force-majeure-related cost spikes. [Private Co.] Private company financial data from public filings may lack detailed income statement disclosure. Normalize on available data and disclose limitations. [Tech Co.] Share-based compensation is the most significant non-cash cost for technology companies. Add it back to derive cash-based EBITDA before computing the multiple for comparability. [Other Entity] For cyclical industry comparables, use mid-cycle EBITDA for both the subject and comparables rather than the latest trailing EBITDA, which may be at a peak or trough.
	Adjustments for Size, Growth, Margin, and Marketability	Adjust the selected multiple to reflect material differences between the subject and the comparable group in revenue scale, growth rate, EBITDA margin, and risk profile. For private companies, apply a discount to reflect the absence of a liquid public market. Document each adjustment with its analytical basis.	Quantify adjustments by reference to observable differentials between subject and comparables. Use regression analysis of EV multiple against growth or margin where the data set permits. Document all adjustments and their analytical basis in the work file and report.	<i>Making purely subjective adjustments without any documented analytical basis.</i> <i>Ignoring material differences in growth or profitability between the subject and the comparable group.</i>	[Listed Co.] For listed companies close to the comparable set in size, adjustments may be minimal. Premium or discount to the median should be substantiated by superior or inferior fundamental attributes. [SME] A size discount relative to large-cap listed comparables is almost always warranted, reflecting higher earnings volatility, lower access to capital, and greater key-person risk. [Project] Adjust for remaining concession life, offtaker credit quality, and financial leverage. Longer remaining term typically supports a higher multiple. [Private Co.] Apply a private company discount for illiquidity and information asymmetry. This functions as a DLOM applied at the multiple selection stage rather than as a post-valuation adjustment. [Tech Co.] Technology multiple adjustment is primarily driven by ARR growth rate, gross margin level, and net revenue retention. Quantify the subject's relative position on each metric versus the comparable set. [Other Entity] For regulated businesses, apply a discount where the regulatory framework constrains returns and limits the business's ability to earn above a prescribed return on capital.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Comparable Transaction Method (Precedent Transactions)					
	Transaction Search and Selection	Search for M&A transactions involving companies similar to the subject. Define search criteria: industry, deal type (control vs. minority stake), deal size, and time period (prefer the last three to five years). Use credible databases with verified transaction data. Document the basis for including or excluding each transaction.	Apply consistent and documented selection criteria across all transactions. Classify each transaction as strategic buyer or financial buyer. Verify total consideration including assumed debt, contingent payments, and non-cash components.	<i>Relying on press reports without verifying the transaction structure.</i> <i>Using transactions older than five years without adjusting for changes in market conditions.</i>	[Listed Co.] Regulatory filings for public company mergers, scheme of arrangement court orders, and listed company disclosures provide verified transaction data. Use these official sources ahead of press reports. [SME] Precedent transactions for SMEs are sparse. Use regional and sector-specific deal databases and supplement with any available private company transaction benchmarks. [Project] Infrastructure deal databases and listed infrastructure fund IPO documents provide benchmarks. Note that infrastructure fund acquisition prices embed leverage and return expectations specific to the fund structure. [Private Co.] PE and VC investment round data from deal databases provide entry valuation benchmarks. For companies that have subsequently listed, DRHP disclosures often reveal pre-IPO transaction prices. [Tech Co.] Technology M&A and VC round data from dedicated databases provide the reference set. For sub-sectors without local precedents, international transactions in the same sub-sector are an acceptable supplement. [Other Entity] For cross-border transactions used as comparables, adjust multiples for differences in tax rates, cost of capital, and growth expectations between the reference jurisdiction and the subject's market.
	Strategic vs. Financial Buyer Distinction	Multiples from strategic buyers embed synergy premiums that overstate standalone value. Financial buyer multiples from private equity and infrastructure funds more closely reflect standalone intrinsic value. Apply the appropriate type based on the engagement purpose and the applicable standard of value.	Classify each comparable transaction as strategic or financial buyer. Apply financial buyer multiples for market value engagements, strategic buyer multiples for investment value. Disclose the classification applied and its impact on the selected multiple range.	<i>Using strategic buyer multiples (with synergy premiums) for a market value or fair value engagement.</i> <i>Assuming all transactions are arm's-length and free of strategic premium without verification.</i>	[Listed Co.] Mandatory offer prices under applicable securities regulations embed a statutory control premium above prevailing market prices. These premiums are not purely market-value evidence. [SME] Most SME transactions are strategic or owner-exit situations. Financial buyer benchmarks from PE entry transactions are rarely available at this scale. [Project] Infrastructure transactions occur between strategic developers and financial sponsors. Distinguish between the two types of buyers and apply the relevant multiple for the purpose of the engagement. [Private Co.] PE entry valuations are the most relevant financial buyer benchmark. Secondary sale transactions between investors provide additional reference points for financial buyer pricing. [Tech Co.] VC financing rounds reflect financial buyer (investor) pricing. Secondary transactions provide strategic vs. financial buyer differential evidence. [Other Entity] For government privatization transactions, the transaction price may reflect political considerations or strategic objectives and may not represent a reliable market value benchmark.



Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Temporal Relevance and Market Cycle Adjustment	Transactions carried out in materially different market conditions particularly those more than three to five years old may not reflect current pricing. Assess the macro and sector conditions at the time of each comparable transaction and apply a judgment-based adjustment where conditions have changed materially.	Note the date and prevailing market conditions for each comparable transaction. Apply a market cycle adjustment for transactions executed at peak or trough valuations. Disclose the dates of all transactions used and explain the basis for any adjustments.	<i>Applying pre-crisis or peak-cycle transaction multiples without adjustment.</i> <i>Treating all transactions as equally relevant regardless of their age or the conditions prevailing at the time.</i>	[Listed Co.] Listed company M&A premiums fluctuate with equity market sentiment. Transactions during periods of particularly high or low market multiples should be used with caution. [SME] Private company transactions are less liquid and tend to lag public market movements. Adjust where there is clear evidence of a material change in the pricing environment. [Project] Infrastructure transaction multiples are influenced by prevailing interest rates and institutional capital availability. Transactions carried out in a low-rate environment may not be directly comparable in the current rate context. [Private Co.] For M&A, use the most recent comparable transactions available. Where no recent transactions exist, explicitly address the age of available data in the report's limiting conditions. [Tech Co.] Technology sector multiples are highly cycle sensitive. The spread between peak and trough EV/Annual Revenue multiples can be several multiples wide. Use transactions from conditions most similar to the current environment. [Other Entity] For cyclical industries, ensure that the selected comparable transactions are representative of mid-cycle conditions rather than being clustered at a cyclical peak or trough.

Cost Approach to Valuation

7.1 Principles and Use Cases

The Cost Approach is one of the recognized valuation approaches. The Cost Approach reflects the amount that would be required to replace the service capacity of an asset, considering the cost of acquiring or constructing a substitute asset of equivalent utility.

In the context of business valuation, the Cost Approach is commonly implemented through the Asset-Based Approach, which determines the value of a business or asset by calculating the net value of its underlying assets and liabilities. This approach is based on the principle that a rational investor would not pay more for a business than the value of the assets that could be acquired or recreated to generate similar economic benefits.

This approach is particularly relevant when valuing capital-intensive businesses, holding companies, investment entities, or companies with limited going concern value.

It is commonly used in the following scenarios:

- Valuation of companies undergoing liquidation or distress
- Investment companies, real estate holding entities, and asset-holding subsidiaries
- Valuations for tax or restructuring purposes where asset values are more relevant than income generation
- Regulatory submissions or financial reporting requiring fair value of specific asset classes

7.2 Book Value vs. Adjusted Net Asset Value

The Book Value and Adjusted Net Asset Value (Adjusted NAV) approaches are fundamental in asset-based valuation. While both rely on the balance sheet as the starting point, the two methods differ significantly in their treatment of asset and liability values.

Understanding the distinction is essential for professional accountants to ensure the selected method reflects the economic reality and serves the intended valuation purpose accurately.

a. Book Value Method

This method uses historical cost accounting figures and is often used for statutory or regulatory purposes, such as determining minimum capital requirements, or when other valuation methods are not feasible. It is also the base case in many start-up valuations, liquidation analyses, or regulatory filings. The Book Value represents the net worth of an entity based on its financial statements, calculated as:

Book Value = Total Assets - Total Liabilities

Limitations:

- Book values may not reflect current market values.
- Intangible assets and contingent liabilities are often understated or omitted.
- Asset impairments and depreciation methods can distort true economic value.



b. Adjusted Net Asset Value (Adjusted NAV) Method

The Adjusted NAV Method refines the book value by restating assets and liabilities to their fair market values as of the valuation date. It provides a more realistic estimate of an entity's worth, particularly in scenarios such as liquidation, investment holding companies, and restructuring.

$$\text{Adjusted NAV} = \sum(\text{Fair Value of Assets}) - \sum(\text{Fair Value of Liabilities})$$

Adjustments may include:

- **Property, Plant & Equipment:** Revalued based on current market prices or appraisals.
- **Investments:** Marked to market or based on recent transactions.
- **Receivables:** Adjusted for doubtful recovery or aging.
- **Contingent Liabilities:** Recognized based on likelihood and quantum.
- **Off-Balance Sheet Items:** Included if economically relevant (e.g., operating leases, guarantees).

This method is more reflective of realizable value, especially for investment entities, asset-rich businesses, and companies undergoing liquidation.

Example:

Particulars	Book Value (NPR)	Fair Value Adjustment (NPR)	Adjusted Value (NPR)
Land and Building	100,000,000	+40,000,000	140,000,000
Plant and Machinery	50,000,000	-5,000,000	45,000,000
Investment in Equity Shares	20,000,000	+10,000,000	30,000,000
Total Assets	170,000,000		215,000,000
Less: Total Liabilities	90,000,000		90,000,000
Adjusted Net Asset Value	80,000,000		125,000,000

7.3 Identification and Revaluation of Assets and Liabilities

In the Asset-Based Approach, particularly under the Adjusted Net Asset Value (Adjusted NAV) Method, the accurate identification and revaluation of assets and liabilities are critical to ensure that the valuation reflects the entity's true economic worth as of the valuation date.

Professional accountants must apply both technical competence and professional judgment in determining which assets and liabilities require adjustment and how their fair values should be measured, keeping in mind the relevant financial reporting standards such as NFRS 13: Fair Value Measurement.

a. Identification of Relevant Assets and Liabilities

All assets and liabilities, whether recognized on the balance sheet or off-balance sheet, should be considered if they have a measurable impact on value. These typically include:

- **Tangible Assets:** Land, buildings, plant and equipment, vehicles, inventories
- **Intangible Assets:** Patents, licenses, trademarks, customer relationships (if separately identifiable)
- **Investments:** Subsidiaries, associates, joint ventures, marketable securities

- **Receivables:** Trade receivables, loans, advances (net of provisions)
- **Liabilities:** Trade payables, borrowings, provisions, accrued expenses, lease liabilities
- **Contingent Liabilities and Off-Balance Sheet Items:** Guarantees, legal claims, operating lease obligations

Proper identification ensures that all components contributing to or detracting from value are included in the valuation.

b. Revaluation Principles and Approaches

Each asset and liability must be reviewed and, where necessary, restated to its fair market value. The appropriate revaluation basis depends on the asset type and market conditions:

➤ **Tangible Fixed Assets**

- For the determination of fair value of land and buildings use of professional valuation reports based on market comparable, particularly in urban and industrial areas.
- Replacement cost less depreciation, adjusted for technological obsolescence and physical condition is appropriate measurement technique for plant and machinery.
- Market price adjusted for age and usage in case of vehicles and equipment.

➤ **Financial Assets**

- Quoted investments are revalued at prevailing market prices.
- Unquoted investments are valued using DCF, comparable company multiples, or latest transaction prices.
- Loans and Advances are assessed for recoverability; impaired assets are adjusted accordingly.

➤ **Inventories**

Revalued at net realizable value (NRV) where lower than cost, especially for slow-moving or obsolete stock.

➤ **Intangible Assets**

Valued if separately identifiable and measurable. For example, a registered trademark used in commercial operations may be valued using relief-from-royalty or multi-period excess earnings method.

➤ **Liabilities and Provisions**

Reassess borrowings, payables, and accrued liabilities at their settlement value. Ensure all known contingent liabilities are reasonably estimated and recognized where applicable.

➤ **Off-Balance Sheet Items**

Evaluate and include items that could materially impact value, such as guarantees, operating leases (to be capitalized if material), or environmental obligations.

Example

A company's plant was recorded at NPR 80 million with accumulated depreciation of NPR 30 million. However, as per professional valuation, the fair market value is estimated at NPR 70 million. Simultaneously, a long-standing receivable of NPR 15 million is deemed irrecoverable and is fully written off.

Adjustments:

- Increase asset value by NPR 20 million (from net book value of NPR 50 million to NPR 70 million)
- Reduce receivables by NPR 15 million

These adjustments directly impact the Adjusted Net Asset Value used for valuation.

c. Practical Considerations

Applying the revaluation process in practice involves professional judgment, reliable data, and, where needed, specialist input. Given the diversity of asset classes and data limitations in the Nepalese context, professional accountants must approach revaluations with care, ensuring that all adjustments are well-supported, compliant, and clearly documented. Professional accountants may consider the following:

- Engaging external specialists such as registered valuers, engineers, or legal experts, particularly for the valuation of complex assets or the assessment of contingent liabilities.
- Ensuring comprehensive documentation of all adjustments, supported by appropriate evidence, and reflecting the valuation as of the specified date.
- Complying with relevant financial reporting standards, including NFRS 13 (Fair Value Measurement), NFRS 9 (Financial Instruments), and NAS 2 (Inventories), as applicable to the asset or liability being evaluated.

7.4 Liquidation Value Method

The Liquidation Value Method estimates the net amount that would be realized if a business were to cease operations and its assets were sold off individually, rather than as a going concern. It is primarily used when a company is no longer viable, undergoing insolvency proceedings, or where the highest value is expected from asset break-up rather than continued operation.

This method is particularly relevant in distressed business scenarios, enforcement of collateral, or for regulatory and judicial proceedings involving dissolution or restructuring.

There are generally two forms of liquidation value:

- Orderly Liquidation** assumes adequate time to find buyers, typically resulting in better realizations.
- Forced Sale or Distress Liquidation** assumes rapid sale under pressure, leading to lower realizable values.

The choice between the two depends on the circumstances of the valuation and the degree of control available over the sale process.

Methodology**a. Asset Identification and Realizable Value Estimation**

Each individual asset is valued based on its expected realizable amount in a liquidation scenario.

This may include:

- Net realizable value of inventories
- Market value of plant and machinery (possibly at scrap value)
- Recoverable amount of receivables (after applying haircuts for collectability)
- Saleable value of property, vehicles, or financial instruments

b. Liability Assessment

All liabilities are assessed at their settlement values, including:

- Secured and unsecured borrowings
- Statutory dues
- Employee benefits obligations
- Trade payables and accrued liabilities

c. Computation of Net Liquidation Value

Net Liquidation Value = Estimated Realizable Value of Assets - Settlement Value of Liabilities

Adjustments may also be made regarding liquidation expenses (legal, administrative, valuation), taxes payable on asset realization and any outstanding contingent liabilities.

Example:

If the adjusted value of plant and machinery is NPR 45 million, but under forced sale conditions it is expected to fetch only 60%, the liquidation value would be:

Liquidation Value = $45,000,000 \times 60\%$ = NPR 27,000,000

Total net realizable value from all assets, less liabilities and liquidation costs, gives the final value under this method.

7.5 Consideration of Contingent Liabilities and Off-Balance Sheet Items

A robust asset-based valuation must account for contingent liabilities and off-balance sheet exposures that could materially affect the net asset value. These may include pending legal disputes, tax assessments, guarantees, or obligations under lease agreements.

Although not always reflected in the financial statements, such items must be identified through management inquiry, legal opinions, and due diligence. If the likelihood of outflow is high and the obligation is estimable, it should be deducted from the ANAV. Similarly, any unrecorded assets, such as rights under contracts or internally generated intangibles, should be considered where appropriate.

Off-balance sheet items vary in nature and may arise from legal, contractual, or operational arrangements. The following are commonly encountered categories:

a. Contingent Liabilities

- Pending or threatened litigation
- Disputed tax assessments
- Guarantees and indemnities provided to third parties
- Environmental obligations
- Warranty claims

b. Contingent Assets

- Claims under litigation expected to be won
- Insurance claims receivable
- Earn-out agreements from prior asset sales

c. Unrecognized Contractual Commitments

- Operating lease obligations (especially under pre-NFRS 16 reporting)
- Long-term purchase contracts at above-market prices
- Binding letters of intent or MOUs with financial implications

d. Structured Financial Arrangements

- Off-balance sheet Special Purpose Vehicles (SPVs)
- Factoring arrangements or securitization
- Undrawn loan facilities and letters of credit

7.5.1 Evaluation of Off-Balance Sheet Items in Valuation

The treatment of these items in valuation depends on their probability of realization, magnitude, and the availability of reliable estimates. Valuers must apply professional judgment in consultation with legal and technical experts where necessary.

a. Contingent Liabilities

- If the likelihood of occurrence is probable and measurable, the estimated liability should be deducted from the net asset value or factored into the DCF cash flows.
- If possible but not probable, a disclosure may suffice, or a probability-weighted value can be used to adjust discount rates or sensitivity scenarios.
- If the occurrence is remote, the item may be excluded but should still be documented and disclosed.

Example: A company has a pending legal case with an estimated penalty of NPR 10 million. Legal counsel assesses a 70% probability of loss. In such a case, the valuer may deduct NPR 7 million ($10M \times 70\%$) from equity value under NAV or reduce expected cash flows accordingly in the DCF approach.

b. Contingent Assets

- Generally, contingent assets are only recognized in valuation if realization is virtually certain and estimable.
- Overly optimistic assumptions should be avoided. Instead, use scenario analysis to demonstrate potential upside cases.

Example: A pending insurance claim of NPR 5 million for fire damage may be considered in valuation if the insurer has acknowledged the claim and is in the final stages of settlement.

c. Lease and Purchase Commitments

- Valuers should review long-term lease agreements and assess whether they are off book but have material financial implications.

- Commitments to purchase inventory or capital assets at fixed prices should be evaluated for pricing risk and adjusted in cost projections.

Example: A long-term lease with undisclosed NPR 15 million in future obligations may be discounted to present value and treated as a liability under the NAV method or reflected in future cash outflows in DCF.

d. Special Purpose Entities and Arrangements

- SPVs and similar off-book structures should be consolidated into the valuation base if the subject company retains the economic benefits or risks.
- Consider the substance over form principle when evaluating such arrangements.

Example: If a subsidiary housing real estate asset is technically not consolidated but is entirely controlled by the parent entity, the valuer should include the fair value of those assets and any associated liabilities.

7.5.2 Practical Guidance for Professional Accountants

To identify off-balance sheet items, professional accountants should:

- Obtain management representations regarding contingent liabilities and commitments.
- Review board meeting minutes, loan covenants, lease agreements, and legal correspondences.
- Consult with legal advisors, external auditors, or valuation specialists as needed.
- Assess whether off-balance sheet exposures are entity-specific or systemic to the industry.

All findings must be clearly documented, even if no valuation impact is ultimately applied.

7.6 Choosing Between NAV and Liquidation Value

In the Asset-Based Approach, practitioners often need to choose between two methods: Adjusted Net Asset Value (ANAV) and Liquidation Value. The selection depends on the operational status of the business and the purpose of the valuation.

If the company is a going concern, the NAV method is generally appropriate. Here, assets and liabilities are revalued to reflect their current fair market values, assuming that the company will continue to operate normally. This method is commonly used for:

- Investment holding companies
- Real estate or infrastructure companies
- Financial restructuring or internal capital reorganization

On the other hand, if the company is facing closure, insolvency, or forced sale, the Liquidation Value method becomes relevant. This approach reflects the net amount that can be realized if the assets are sold off and liabilities settled, typically under less favorable market conditions. It is used in:

- Bankruptcy and dissolution proceedings
- Valuation of distressed companies
- Exit strategies or special situations

The choice should be clearly documented in the valuation report, including justification based on the company's financial condition and intended use of the valuation outcome.



7.7 Factors Affecting the Asset-Based Approach

Several factors influence the reliability and appropriateness of the Asset-Based Approach. Professional Accountants should evaluate the following considerations before and during the engagement:

a. Nature of Business Assets

Companies with significant tangible or financial assets such as property developers, leasing companies, and investment firms are well-suited for asset-based valuation. In contrast, service-based or Intellectual Property (IP)-driven businesses may be undervalued by this method.

b. Accuracy and Availability of Data

Updated fixed asset registers, investment schedules, property ownership documents, and details of liabilities are critical. Incomplete or outdated data may result in material misstatements.

c. Market Conditions and Valuation Inputs

Fair values must reflect prevailing market conditions. If there is market volatility or illiquidity, values derived through external appraisals or third-party inputs should be stress-tested or qualified.

d. Unrecorded or Contingent Items

Hidden liabilities such as tax penalties, legal claims, or off-balance sheet guarantees must be carefully reviewed and considered. Undisclosed assets, like land held in related entities or unregistered intellectual property, should also be identified if material.

e. Cost-Benefit Consideration

Especially in small-scale entities, the cost and time required for a detailed asset-based valuation (e.g., for multiple real estate sites or machinery valuations) may outweigh its usefulness. Practitioners should assess feasibility early in the process.

These factors must be disclosed in the valuation report, particularly if they affect reliability, scope, or assumptions.

7.8 Conclusion

The Cost Approach provides a direct and transparent method of valuing a company's net worth based on its underlying assets and liabilities. It is best applied where earnings-based valuations are not suitable particularly for holding companies, asset-rich entities, or distressed businesses.

While straightforward in application, this approach demands careful judgment in identifying and adjusting for fair value, evaluating contingent liabilities, and ensuring the completeness of asset listings. Its utility is enhanced when reliable data, valuation reports, and legal documents are available to support adjustments.

Professional Accountants should apply this approach where appropriate and ensure that all key assumptions, exclusions, and valuation adjustments are clearly explained. Where necessary, the Asset-Based Approach may be combined with income or market methods to support a more balanced valuation opinion.

Practice Notes: Asset-Based Approach (Net Asset Value and Adjusted Net Asset Value Methods)

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Applicability and Premise					
	When to Apply the Asset Approach	The asset approach is the primary method for investment holding companies, real estate entities, businesses where asset value exceeds going-concern earnings value, and distressed or non-going-concern situations. For operating businesses, it serves as a floor value cross-check alongside the income or market approach.	Assess whether assets or earnings are the primary driver of value. Apply as primary method for holding companies, real estate, and non-operating entities. Use as a floor value cross-check even when another approach is primary	<i>Applying the asset approach to an operating business where earnings drive value this systematically undervalues goodwill and intangible franchises.</i> <i>Using the book value of assets as a proxy for market value.</i>	[Listed Co.] For listed companies, the asset approach is used for: holding company discount analysis (SOTP net asset value vs. market capitalization), impairment testing, and corporate restructuring valuations. [SME] The asset approach is appropriate when the business is below break-even, the owner is liquidating, or the business is asset-heavy relative to its earning capacity. [Project] For single-asset project entities, depreciated replacement cost provides a useful cross-check on the income approach value. At end of concession, asset reversion value drives the terminal value. [Private Co.] Private company ANAV is frequently used for estate planning, partnership dissolution, and litigation. It is the primary method for investment holding entities. [Tech Co.] The asset approach is rarely the primary method for technology companies. It may be used for NAV per share computations for regulatory purposes or for liquidation analysis in distress scenarios. [Other Entity] For cooperative societies, trusts, and government entities, net asset value may be the only practicable approach where no analogous market transactions exist.
Tangible Asset Valuation Assumptions					
	Land and Real Property	Value land at current market value using the sales comparison approach recent comparable registered transactions adjusted for location, size, shape, frontage, zoning, and encumbrances. Value buildings at depreciated replacement cost or income capitalization. Engage a registered property valuer for material assets.	Obtain a registered valuer's certificate for material real property. Use recent comparable transaction data from official registry records. Apply adjustments for encumbrances, usage restrictions, and prevailing market conditions.	<i>Using government circle or stamp duty guidance rates as market value these are systematically below market in most locations.</i> <i>Applying historical book value without independent market assessment.</i>	[Listed Co.] Material real property of listed companies should be independently valued by a registered professional. Investment properties should be carried out at fair value under applicable accounting standards. [SME] Property values are often the single largest asset in the ANAV for asset-heavy SMEs. The valuation must be based on observable market transactions, not the official rate used for registration purposes. [Project] For concession-based projects, land may be provided by the government and may not be owned by the project entity. Confirm land rights, the terms of the right to use, and reversion obligations. [Private Co.] Promoter-owned property leased to the company must be excluded from ANAV, it is an asset of the promoter, not the entity. Treat it as an operating lease liability and note the arrangement. [Tech Co.] Technology companies typically have minimal real property. Office space is generally leased and recorded as a right-of-use asset under applicable lease accounting standards not real property for ANAV purposes. [Other Entity] For real estate development entities, value each land parcel and project separately at current market value, adjusted for development stage and the status of regulatory approvals.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Plant, Machinery, and Equipment	Value plant and equipment at depreciated replacement cost (DRC) replacement cost new less physical deterioration, functional obsolescence, and economic obsolescence or at secondary market realizable value where an active resale market exists.	Obtain asset specification, age, and condition data Source current replacement costs from manufacturer or equipment dealer price lists. Apply separate depreciation factors for physical, functional, and economic obsolescence	<i>Using book value as market value is almost never a reliable proxy.</i> <i>Ignoring functional obsolescence from advances in newer equipment technology.</i>	[Listed Co.] Capital-goods-intensive listed companies should have independent plant valuations for material asset blocks. Cross-check DRC against insurance reinstatement values as a reasonableness test. [SME] For manufacturing SMEs, DRC is the standard approach. Import-dependent equipment requires a current replacement cost at import parity not the historical purchase cost. [Project] Electro-mechanical project assets have established replacement cost benchmarks. Physical depreciation must reflect actual operating hours and maintenance history not calendar age alone. [Private Co.] Specialized equipment with thin secondary markets should be valued at DRC. Document the market evidence (or absence thereof) for secondary market realizable values. [Tech Co.] Server and computing equipment carry rapid economic obsolescence cloud migration has materially reduced the demand for on-premise hardware. DRC must reflect current useful life, not original specifications. [Other Entity] For healthcare entities, biomedical equipment carries specialized replacement costs and regulatory certification requirements. Engage a specialist where the equipment block is material to the ANAV.
	Inventories	Value finished goods at net realizable value estimated selling price less costs to complete and sell. Value raw materials at current replacement cost. Value work-in-progress at NRV adjusted for stage of completion. Identify and write down slow-moving or obsolete items.	Obtain an aged inventory analysis by category. Write down slow-moving stock (typically items with no movement for more than twelve months) to NRV. Confirm the entity's cost accounting policy and its consistency with the valuation basis	<i>Accepting all inventory at book cost without NRV assessment.</i> <i>Failing to identify and write off obsolete, expired, or unsaleable stock.</i>	[Listed Co.] Applicable accounting standards require inventory at the lower of cost and NRV. Validate the adequacy of any provisions made against an independent aged analysis. [SME] Inventory write-downs are frequently under-provided in SME accounts. Physical verification and independent age analysis should be conducted as part of due diligence. [Project] Project inventories consist primarily of spare parts and consumables. Value at procurement cost for recent items; mark down aged spares based on the remaining useful life of the associated equipment. [Private Co.] Import-dependent businesses may hold significant in-transit and bonded inventory. Confirm ownership status, customs duties payable, and NRV for each category. [Tech Co.] Technology companies have minimal physical inventory. Hardware bundled with software products is the primary exception; assess NRV based on sell-through rates and shelf life. [Other Entity] For pharmaceutical businesses, differentiate between active pharmaceutical ingredients, work-in-process, and finished goods each requires a different valuation basis and shelf-life assessment.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Receivables and Financial Assets	Value trade receivables at expected recoverable amount face value less a provision for doubtful and irrecoverable debts based on an expected credit loss assessment. Use debtor ageing, historical collection experience, and current economic conditions as inputs.	Obtain a debtor ageing report analyzed by customer. Apply expected credit loss provision rates grounded in historical collection data and current conditions. Scrutinize related-party and inter-company receivables for recoverability	<i>Accepting all receivables at face value without credit loss assessment.</i> <i>Assuming government or institutional receivables are risk-free and fully collectable without evidence.</i>	[Listed Co.] Audited financial statement notes provide the basis for assessing provision adequacy. An independent assessment may reveal under-provisioning in distressed or competitive industries. [SME] Related-party receivables from promoters or affiliated entities are common and frequently difficult to recover. Treat these as equity-equivalent and deduct from ANAV unless recoverability is clearly demonstrated. [Project] Receivables from government offtakers may have significant ageing but low default risk. Use a risk-adjusted provision rather than a standard time-based provision. [Private Co.] Capital advances to suppliers outstanding beyond the agreed delivery date require full provisioning unless there is concrete evidence of planned delivery. [Tech Co.] Receivables from subscription contracts are generally low-risk due to annual billing in advance. Confirm the proportion of prepaid vs. arrears billing and the associated credit risk profile. [Other Entity] For financial institutions, the quality of the loan portfolio drives the fair value of the receivables book. An independent credit assessment of large or distressed exposures may be required.
	Listed and Unlisted Investments	Value listed investments at the closing market price on the valuation date. Value unlisted equity investments using an appropriate valuation method applied to the investee entity DCF, net asset value, or market multiple as determined by the nature of the investee business.	Confirm the exchange closing price for each listed investment as at the valuation date. Apply an appropriate valuation method to each unlisted investee individually. Assess each investment for impairment against its carrying value	<i>Using the cost of investment as its current value.</i> <i>Applying a single method to all unlisted investments regardless of the nature of each investee.</i>	[Listed Co.] Listed share values are directly observable. For large positions where an immediate sale would be impractical, consider a block trade discount to the prevailing market price. [SME] Unlisted company shares held as investments require a sub-valuation of the investee entity. This may require access to investee financials and the application of a full valuation methodology. [Project] Investments in other project entities should be valued using the DCF method applied to the investee project, reflecting its specific contract terms and remaining concession period. [Private Co.] Private equity stakes in other entities require individual sub-valuations. For very small stakes in early-stage entities, the cost method may be an acceptable proxy if no better information is available. [Tech Co.] Investments in other start-ups held at cost should be reviewed for impairment. The most recent financing round of the investee provides a market-based reference if the round was at arm's length. [Other Entity] For holding company SOTP valuations, the investment portfolio drives the entire ANAV. Each material investment requires an individual valuation with its own set of assumptions.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Intangible Asset Identification and Valuation					
	Systematic Intangible Identification	Conduct a systematic identification of all intangible assets both recognized on the balance sheet and unrecognized but economically material.	Assess each identified intangible for separability and measurable economic benefit. Document the basis for including or excluding each identified intangible	<i>Omitting unrecognized intangibles because they do not appear on the balance sheet.</i> <i>Attributing all unidentified residual value to goodwill without attempting individual identification</i>	[Listed Co.] Business combination disclosures in prior year accounts (purchase price allocation from previous acquisitions) provide a framework for identifying the types of intangibles present in the business. [SME] SMEs rarely carry recognized intangibles beyond software licenses. However, unrecognized intangibles brand, customer relationships, proprietary processes may be significant relative to overall business value. [Project] The primary intangible is the concession or license right. This is often recognized on the balance sheet under service concession arrangement accounting. Confirm the accounting treatment and remaining amortization life. [Private Co.] Business name, local brand recognition, customer relationships, franchise agreements, and exclusive distribution rights are common unrecognized intangibles in owner-managed businesses. [Tech Co.] Core intangibles: software platform and code base, algorithms and AI models, proprietary datasets, patents, registered trademarks, domain names, and subscriber or user base. [Other Entity] For pharmaceutical entities: drug formulations, regulatory approvals, clinical data packages, and manufacturing know-how are significant intangibles requiring separate identification and valuation.
	Brand and Trademark Valuation	Value brands using the Relief from Royalty method (royalty savings from owning the brand, capitalized at an appropriate discount rate), the Premium Price method (price premium over generic equivalents), or the Excess Earnings method for brands that drive the majority of business value.	Use market-derived royalty rates from comparable licensing agreements Applying a discount rate higher than WACC brands carries greater risk than the business as a whole. Cross-check using at least two methods where data permits.	<i>Selecting royalty rates without market evidence from comparable licenses.</i> <i>Applying WACC to brand income streams this understates the risk premium appropriate for intangible assets.</i>	[Listed Co.] Listed consumer, FMCG, and media companies carry significant brand value. Published brand valuation studies provide corroborating evidence for royalty rate selection. [SME] SME brands are typically regional or niche. Apply a lower royalty rate and a higher discount rate, reflecting lower brand strength and more limited legal protection compared with established brands. [Project] Project entities do not typically carry brand value. The sponsor or developer brand may be relevant for project development activities but does not reside in the SPV. [Private Co.] For private companies with regional brands in retail, food and beverage, or professional services, Relief from Royalty is the most operationally practicable approach. [Tech Co.] Technology brand value is evidenced by organic traffic share, app ratings, net promoter scores, and social following. Relief from Royalty using platform or marketplace royalty rates is appropriate for consumer technology brands. [Other Entity] For professional services firms, brand value is closely tied to key individuals. Adjust for personal vs. institutional brand strength a significant portion may not be transferable to a new owner.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Customer Relationships	Value customer relationships using the Multi-Period Excess Earnings Method: project revenue and earnings attributable to the existing customer base, deduct contributory asset charges for all supporting assets, and discount at a rate reflecting the risk of customer attrition which is higher than the overall business WACC.	Estimate customer attrition rate from historical cohort data. Project revenue and earnings from existing customers over the economic life of the relationship. Apply contributory asset charges for all assets supporting the customer revenue stream	<i>Using total business cash flow rather than only the portion attributable to existing customer relationships.</i> <i>Applying insufficient contributory asset charges this overstates the residual earnings attributable to the customer relationship.</i>	[Listed Co.] For listed companies undergoing acquisition accounting, customer relationships are typically the most significant separately identified intangible in the purchase price allocation. [SME] Customer attrition for SMEs depends on the depth of the relationship and the contractual arrangement. Long-standing customers with multi-year agreements have materially lower attrition than transactional buyers. [Project] The offtake or power purchase agreement is effectively the customer relationship intangible. Its value is the present value of the revenue stream over the remaining contract term. [Private Co.] For B2B businesses with long-term supply contracts, the economic life of the customer relationship extends to the remaining contract term plus expected renewals based on the entity's historical renewal rate. [Tech Co.] For subscription-based businesses, the customer relationship is represented by the existing ARR book and its expected retention. Net Revenue Retention and logo retention rate are the key empirical inputs to attrition estimation. [Other Entity] For financial institutions, the stable deposit base (core depositor relationships) is a material intangible commonly referred to as the Core Deposit Intangible in banking acquisition accounting.
	Technology, Software, and Intellectual Property	Value internally developed technology software platforms, algorithms, data models using the Relief from Royalty or Replacement Cost method. Value patents and registered IP using an income-based approach: the present value of income attributable to the protected technology, discounted over the remaining protection period.	Obtain the IP register and confirm legal ownership of each asset. For the cost approach: estimate the fully loaded cost to recreate the technology from scratch at current input costs. For the income approach: isolate the income attributable to technology from other business income.	<i>Valuing technology at its historical development cost without considering obsolescence.</i> <i>Attributing all business income to technology without isolating the technology-specific contribution from other assets</i>	[Listed Co.] For listed technology product companies, the core platform is typically the primary value driver. Distinguish between owned IP (where the full value resides in the entity) and licensed IP (where only the license value is relevant). [SME] Proprietary software developed by an SME should be valued using replacement cost adjusted for functional obsolescence relative to commercially available alternatives. [Project] Project SPVs typically do not own proprietary technology. Technology performance risk (design and operating risk) is a project risk relevant to cash flow assumptions, not a separable intangible asset. [Private Co.] Legal protection of IP patents filed, trademarks registered, trade secrets documented strengthens the defensibility of the intangible valuation. Unregistered IP has lower protective value. [Tech Co.] Value separately: core product platform, AI and machine learning models with proprietary training data, patents and patent applications, and domain names. Each requires its own methodology. [Other Entity] For pharmaceutical entities, each drug formulation or regulatory approval is valued over its remaining commercial life the patent-protected period and the expected post-patent generic competition phase.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
Liability Assessment					
	Financial Debt at Fair Value	Value interest-bearing financial debt at fair market value. Where debt carries market-rate terms and the borrower's credit profile has not changed materially, book value approximates fair value. For fixed-rate debt in a materially different interest rate environment, compute fair value by discounting contractual cash flows at current market rates.	Identify all interest-bearing liabilities including lease obligations under applicable accounting standards. Assess book-to-market value difference for fixed-rate instruments. Include off-balance-sheet debt equivalents: guarantees, letters of credit, and contingent payment obligations.	<i>Using book value of fixed-rate bonds when interest rates have shifted materially since issuance.</i> <i>Omitting guarantees and corporate sureties issued on behalf of group companies.</i>	[Listed Co.] Listed debt securities can be marked to current market price. For privately placed instruments, discount future contractual cash flows at the current yield for an equivalent credit rating. [SME] SME debt is predominantly floating-rate bank debt. Book value typically approximates fair value. Confirm whether any prepayment penalties or exit fees affect the fair value of existing facilities. [Project] Long-tenor fixed-rate project finance debt may have a material difference between book and fair value in a changed rate environment. Compute fair value by discounting at the current project lending rate. [Private Co.] Related-party loans at non-market rates must be adjusted to market-rate equivalents. The difference between the stated carrying amount and the market-rate equivalent is an equity adjustment in ANAV. [Tech Co.] Venture debt and convertible notes require bifurcation into debt and equity components. The conversion option or warrant component is equity includes it in the equity section of ANAV, not liabilities. [Other Entity] For entities with significant lease obligations recognized under applicable lease accounting standards, the lease liability is an interest-bearing financial liability and must be included in the ANAV debt schedule.
	Contingent and Off-Balance-Sheet Liabilities	Identify and probability-weight all contingent liabilities: pending litigation, tax disputes, regulatory penalties, environmental obligations, corporate guarantees, and put options granted on subsidiary or investee shares. Apply an expected value approach using probability and estimated outflow.	Review legal counsel letters for litigation status and exposure quantum. Review of all outstanding tax assessment orders and demands under appeal. Confirm the status of regulatory investigations and environmental compliance obligations.	<i>Omitting disclosed contingent liabilities from the ANAV.</i> <i>Treating all pending tax demands as immaterial without individual assessment.</i>	[Listed Co.] Contingent liability disclosures in audited accounts are the starting point. Cross-reference against auditor emphasis of matter paragraphs and qualification notes for additional identified risks. [SME] Tax demands from revenue authorities are frequently the largest contingent liability for SMEs. Assess the legal merits of each demand in consultation with the entity's tax advisor. [Project] Force majeure arbitrations, contractor claim disputes, and regulatory penalty proceedings are common contingent liabilities for infrastructure projects. Obtain a legal assessment of each. [Private Co.] Cross-group guarantees, promoter personal guarantees with cross-default implications, and inter-group financial support obligations require disclosure and probability-weighted assessment. [Tech Co.] IP infringement claims, employment-related proceedings from workforce reductions, and data privacy regulatory risk are material contingent liabilities specific to technology companies. [Other Entity] For healthcare entities, professional liability claims and product liability suits may be significant but undisclosed. Conduct independent legal due diligence to identify claims outside the balance sheet.

Ref.	Area	Assumption / Description	Key Considerations	Common Pitfalls	Practice Notes by Entity Type
	Employee Benefit and Retirement Liabilities	Assess and include all employee benefit liabilities: defined benefit obligations (gratuity, pension, post-retirement medical) valued using the Projected Unit Credit method; accrued leave encashment; provident fund contribution arrears; and any pending wage settlement obligations.	Obtain an actuarial valuation for all material defined benefit plans. Verify that statutory contribution obligations are current and fully paid. Identify and quantify any pending wage revision or collective bargaining settlement liabilities.	<i>Using management approximations for material gratuity or pension obligations without actuarial support.</i> <i>Assuming all employee benefit liabilities are fully provisioned without independent verification.</i>	[Listed Co.] Audited accounts include actuarial valuation disclosures. Review the assumptions used discount rate, salary escalation, mortality table, attrition rate for consistency with current market conditions. [SME] SMEs frequently under-provide for gratuity and leave encashment. An actuarial assessment, often conducted for the first time as part of an M&A due diligence, commonly reveals significant unrecognized liabilities. [Project] Project entities with long-tenured operations and maintenance staff accumulate significant gratuity liabilities. These are often inadequately funded and require actuarial assessment. [Private Co.] Family-managed businesses often make ad hoc gratuity and ex-gratia payments rather than maintaining actuarially calculated provisions. Quantify the gap between ad hoc payments and statutory entitlements. [Tech Co.] Technology companies have younger workforces with higher attrition, reducing gratuity exposure. However, equity compensation repurchase commitments and put rights granted to employees may be significant. [Other Entity] For cooperative societies and government entities, pension obligations may be defined benefit and entirely unfunded. This constitutes a material off-balance-sheet liability that must be quantified.

Comparative Applicability of Valuation Approaches Based on Basis and Premise of Value

Valuation Approach	Typical Basis of Value	Appropriate Premise of Value	Business / Asset Characteristics Where Most Suitable
Income Approach	• Fair Value • Market Value • Investment Value	Going Concern	• Operating businesses with stable or predictable cash flows • Service businesses • Technology companies • Businesses where value is driven by future earnings and intangible assets
Market Approach	• Market Value • Fair Value	Going Concern	• Businesses operating in industries where comparable companies or transactions are observable • Listed companies • Sectors with active M&A activity
Cost Approach	• Fair Value • Net Asset Value • Liquidation Value	• Liquidation premise or asset realization premise • Going concern for asset-intensive entities	• Asset-holding companies • Investment entities • Real estate companies • Capital-intensive businesses • Distressed companies • Early-stage entities with limited operating history

In practice, valuers may apply multiple valuation approaches where appropriate. The selection and weighting of approaches should be based on:

- the basis of value required for the assignment,
- the premise of value (such as going concern or liquidation),
- the nature and stage of development of the business, and
- the availability and reliability of relevant financial and market data.

Where more than one approach is used, the valuer should apply professional judgment in reconciling the results to arrive at a reasonable and well-supported valuation conclusion, and the rationale for selecting and weighting the approaches should be clearly documented in the valuation report.

Valuation of Tangible Assets

8.1 Overview

Tangible assets are physical items owned by a business that are used in operations or held for investment purposes. These include land, buildings, plant and machinery, vehicles, furniture, and equipment. Tangible asset valuation is essential in various contexts, such as:

- Financial reporting (e.g., fair value measurement under NFRS 13)
- Mergers, acquisitions, or restructuring
- Regulatory filings and insurance purposes
- Loan security assessments and liquidation scenarios

The valuation of tangible assets must reflect their fair market value and the price at which they could be exchanged in an orderly transaction between knowledgeable and willing parties. For specialized assets, where active markets may not exist, professional judgment and expert appraisals are often necessary.

8.2 Valuation Methodology

Valuing tangible assets typically involves one or more of the following approaches:

Market Approach

Values are determined by referencing sales of comparable assets in the open market. This approach is most effective for assets like land, buildings, and vehicles where active markets exist. Adjustments are made for location, size, age, and condition.

Example: Valuing Real Estate

A company owns a commercial building. To value this building using the market approach, follow these steps:

Identify Comparable Properties: Find similar properties that have been sold recently. Suppose three comparable properties sold for NPR 1,000,000, NPR 1,200,000, and NPR 1,100,000.

Adjust for Differences: Adjust the prices of these properties for differences in location, size, condition, etc. After adjustments, the comparable prices might be NPR 1,050,000, NPR 1,150,000, and NPR 1,100,000.

Calculate Average Price: Compute the average of the adjusted prices. $\text{Average Price} = (1,050,000 + 1,150,000 + 1,100,000) / 3 = 1,100,000$

Thus, the building's value is NPR 1,100,000 using the market approach.

Real Estate can also be valued by using expert's service such as engineer to determine the average price of the property.

Cost Approach for valuation of Tangible Assets

The asset's value is based on the cost to replace or reproduce it, less depreciation. This is commonly applied for plant and machinery or specialized buildings where no direct market comparable are available.

a. Historical Cost Method

The historical cost method is a fundamental accounting principle where an asset or liability is recorded at its original purchase price at the time of the transaction. This method of valuation is relevant when entity has presented its assets in market value in financial statement and valuation is to be analyzed for regulatory filing on cost basis.

b. Replacement Cost Method

The Replacement Cost Method estimates the amount required to acquire or construct a new asset with equivalent utility as the subject asset using modern materials, design, and technology. This method does not seek to replicate the asset exactly but rather focuses on its functional equivalency.

A market participant would be indifferent between the subject asset and a modern equivalent that performs the same function at the same level of efficiency.

Steps Involved:

- 1. Determine Replacement Cost New (RCN):** Estimate the cost to replace the asset with a new one of equivalent utility using current prices, materials, and technologies.
- 2. Deduct Depreciation:** Account for three types of depreciation:
 - » Physical Deterioration – wear and tear from use or aging
 - » Functional Obsolescence – reduction in value due to outdated technology or design inefficiencies
 - » Economic Obsolescence – external factors like market decline, regulation, or industry shifts
- 3. Adjust for Installation and Indirect Costs:** Include freight, handling, foundation, electrical fittings, installation, commissioning, and professional fees.
- 4. Determine Final Value:** Replacement Cost New minus all forms of depreciation gives the Fair Value.

c. Reproduction Cost Method

The Reproduction Cost Method estimates the cost to recreate an exact replica of the subject asset including the same materials, design, technology, and specifications as of the valuation date.

The valuation is based on constructing or producing an asset identical in every aspect to the existing one, regardless of whether newer, more efficient alternatives exist.

Steps Involved:

- 1. Estimate Reproduction Cost New (RCN):** Determine the cost to duplicate the asset in its current form and specification using prevailing market prices for identical inputs.
- 2. Deduct Depreciation Factors:** Same as under the replacement cost method:
 - » Physical depreciation
 - » Functional obsolescence
 - » Economic obsolescence

- 3. Arrive at Fair Value:** Subtract all depreciation and obsolescence to determine the value of the existing asset.

Example: Valuing Machinery

Let's consider a company that owns a piece of machinery used in manufacturing. The steps to value this machinery using the cost approach are:

Determine Replacement Cost: Identify the current cost to replace the machinery with a similar new piece. Suppose the replacement cost is NPR 500,000.

Calculate Depreciation: Estimate the accumulated depreciation based on the machine's age and useful life. If the machine is 5 years old with a useful life of 10 years and straight-line depreciation, the depreciation is 50%. Thus, accumulated depreciation is NPR 250,000.

Calculate Net Book Value: Subtract accumulated depreciation from the replacement cost.

$$\begin{aligned}\text{Net Book Value} &= \text{Replacement Cost} - \text{Accumulated Depreciation} \\ &= \text{NPR } 500,000 - \text{NPR } 250,000 = \text{NPR } 250,000\end{aligned}$$

So, the machinery's value is NPR 250,000 using the cost approach.

Income Approach (Limited Use)

Applied in specific cases where a tangible asset (such as a leased property or power plant) independently generates a predictable income stream. Here, the asset is valued by discounting the net income attributable to it.

Example: Valuing Rental Property

A company owns a rental property that generates annual rental income of NPR 100,000. To value this property using the income approach:

Estimate Net Operating Income (NOI): Calculate the net income after operating expenses. Suppose operating expenses are NPR 20,000, so NOI is NPR 80,000. $\text{NOI} = \text{Annual Rental Income} - \text{Operating Expenses} = \text{NPR } 100,000 - \text{NPR } 20,000 = \text{NPR } 80,000$

Determine Capitalization Rate: Identify an appropriate capitalization rate (cap rate) based on market conditions. Suppose the cap rate is 8%.

Calculate Property Value: Use the cap rate to determine the property's value. $\text{Property Value} = \text{NOI} / \text{Capitalization Rate} = 80,000 / 0.08 = 1,000,000$

Therefore, the rental property's value is NPR 1,000,000 using the income approach.

The selected methodology should reflect the nature of the asset, availability of market data, and purpose of valuation. In most cases, third-party valuation reports or appraisals are obtained, especially for high-value assets or where regulatory review is involved.

8.3 Depreciation and Obsolescence Considerations

When applying the cost approach or interpreting book values, depreciation and obsolescence must be properly considered to determine the asset's current fair value.

- a. Physical Depreciation:** Reflects wear and tear over time due to usage and aging. For example, an



industrial machine with a 10-year useful life will depreciate annually based on usage, condition, and maintenance history.

- b. Functional Obsolescence:** Arises when an asset is less efficient or technologically outdated compared to modern alternatives. For instance, a factory building designed for outdated workflows may be functionally obsolete despite being structurally sound.
- c. Economic Obsolescence:** Occurs when external factors such as reduced market demand or regulatory changes reduce the asset's economic utility. For example, land zoned for industrial use may lose value if the surrounding area is rezoned for residential development.

Valuers must assess all three forms of depreciation when estimating the adjusted value of tangible assets and should rely on engineering reports, technical specifications, or market comparable to support these assessments.

Detailed Examples

Example 1: Valuing a Manufacturing Plant

A company owns a manufacturing plant with the following details:

Replacement cost of the plant: NPR 5,000,000

Age of the plant: 10 years

Useful life: 25 years

Comparable sales: Three similar plants sold for NPR 4,800,000, NPR 5,200,000, and NPR 4,900,000

Annual net income generated: NPR 500,000

Capitalization rate: 10%

Cost Approach:

Determine Replacement Cost: NPR 5,000,000

Calculate Depreciation: The plant has used 10 out of 25 years, so 40% of its life.

Depreciation = $0.40 \times 5,000,000 = 2,000,000$

Calculate Net Book Value: Net Book Value = $5,000,000 - 2,000,000 = \text{NPR } 3,000,000$

Market Approach:

Comparable Sales: NPR 4,800,000, NPR 5,200,000, NPR 4,900,000

Adjust for Differences: Suppose adjustments lead to NPR 4,850,000, NPR 5,150,000, and NPR 4,950,000.

Calculate Average Price: Average Price = $(4,850,000 + 5,150,000 + 4,950,000) / 3 = 4,983,333$

Income Approach:

Net Operating Income (NOI): NPR 500,000

Capitalization Rate: 10%

Calculate Plant Value: Plant Value = $\text{NPR } 500,000 / .10 = \text{NPR } 5,000,000$

The values obtained using different approaches are:

Cost Approach: NPR 3,000,000

Market Approach: NPR 4,983,333

Income Approach: NPR 5,000,000

Example 2: Valuing Inventory

A company has inventory with the following details:

Cost to purchase: NPR 500,000

Market value of similar inventory: NPR 520,000

Net realizable value (NRV): NPR 480,000

Cost Approach:

Determine Purchase Cost: NPR 500,000

Calculate Obsolescence or other losses: Suppose 10% obsolescence.

Obsolescence = $0.10 \times 500,000 = 50,000$

Calculate Net Book Value: Net Book Value = $500,000 - 50,000 = 450,000$

Market Approach:

Market Value: 520,000

Income Approach:

Net Realizable Value (NRV): 480,000

The values obtained using different approaches are:

Cost Approach: NPR 450,000

Market Approach: NPR 520,000

Income Approach: NPR 480,000

8.4 Role and Contribution of Experts

Professional accountants often need to rely on qualified external specialists, particularly for complex or technical tangible assets. The following procedures apply:

- Engineers and Quantity Surveyors: For estimating replacement cost of plant, buildings, or infrastructure.
- Registered Valuers: For market-based appraisal of real estate or specialized machinery.
- Environmental Experts: For assets subject to environmental compliance or remediation.
- Legal Advisors: For land title verifications, leasehold interests, or encumbrances affecting value.

When engaging such experts:

- Their credentials must be reviewed and documented.
- Their reports should be appended or cited in the valuation documentation.
- The accountant must assess the reasonableness of the assumptions and conclusions drawn by the expert.

Note: As per the ICAN Code of Ethics, IVS 101 and IVS 105, the work of experts should be appropriately acknowledged, and reliance disclosed in the final report.



8.5 Documentation and Reporting

Each valuation involving tangible assets should include:

- Description of the asset (location, capacity, age, use)
- Methodology used (with rationale)
- Source of data and basis of estimates
- Expert reports or certifications (if applicable)
- Any assumptions made regarding useful life, salvage value, or market conditions

These details should form part of the working papers and, where material, be disclosed in the final valuation report.

8.6 Conclusion

Tangible asset valuation is a critical component of many valuation engagements, particularly when applying the asset-based approach or complying with fair value reporting requirements. The choice of methodology depends on the asset type, available market data, and context of the valuation.

Professional Accountants must ensure that valuation of tangible assets is based on appropriate assumptions, supported by external evidence or expert reports, and reflects all relevant depreciation and obsolescence factors. Where necessary, reliance on qualified valuers or appraisers should be disclosed in the valuation report, along with a clear explanation of the methodology and basis for conclusions reached.

Valuation of Intangible Assets

9.1 Overview and Classification

Intangible assets are non-physical assets that provide long-term economic benefits to a business. These include intellectual property, contractual rights, licenses, software, brand names, customer relationships, and goodwill. Unlike tangible assets, intangibles are often difficult to identify, measure, and value, especially if internally generated.

Classification of Intangible Assets:

Marketing-related: Trademarks, trade names, internet domains

Customer-related: Customer contracts, relationships, order backlog

Technology-related: Patents, proprietary software, technical designs

Contract-based: Licensing agreements, franchise rights, permits

Artistic-related: Copyrights, production rights

Internally generated intangibles are generally not recognized in financial statements (except in specific cases like development costs under NAS 38). However, for transaction, tax, or strategic decision-making purposes, their valuation remains critical.

9.2 Income-Based Methods

Income-based approaches are widely used in valuing intangible assets, especially when they are expected to generate measurable future economic benefits. The key idea is to estimate future cash flows attributable to the intangible and discount them to present value.

a. Relief from Royalty Method

This method estimates the value of an intangible by determining the amount a company would have to pay in royalties if it did not own the asset and instead licensed it from a third party. It is commonly used for trademarks, brands, and intellectual property.

Steps:

1. Estimate future revenues attributable to the intangible asset.
2. Determine an appropriate royalty rate (based on industry benchmarks or comparable license agreements).
3. Multiply projected revenues by the royalty rate to estimate royalty savings.
4. Apply the appropriate tax adjustment to reflect after-tax savings.
5. Discount the resulting net cash flows to present value using an appropriate discount rate.

Example:

A brand generates NPR 100 million in annual revenues. A comparable licensing agreement in the industry shows a 2% royalty rate. Assuming a 5-year benefit period and a discount rate of 12%:

Annual Royalty Savings = NPR 100 million $\times$ 2% = NPR 2 million

Present Value over 5 years $\approx$ NPR 7.2 million

This becomes the estimated value of the brand.

b. Multi-Period Excess Earnings Method (MPEEM)

This method isolates the earnings attributable to a specific intangible (e.g., customer relationships) after deducting charges for the use of contributory assets like working capital, technology, and workforce. It is considered one of the most technically robust valuation methods but requires detailed financial modeling. Most suitable for intangible assets that are the primary driver of cash flows such as customer relationships, proprietary technology, or core patents.

Steps:

1. Forecast future revenues and derive free cash flows to the firm.
2. Deduct contributory asset charges (CACs) for other supporting assets used in generating those cash flows (e.g., return on PP&E, working capital, assembled workforce).
3. The residual cash flows represent the “excess earnings” attributable to the intangible asset.
4. Discount these excess earnings to present value using a rate appropriate for the risk associated with the intangible.

Example:

A proprietary technology generates total projected cash flows of NPR 15 million annually. After deducting CACs of NPR 5 million (for tangible and other intangible assets), the excess earnings are NPR 10 million. Discounting this stream at 15% over its 8-year useful life gives the value of the technology.

c. With and Without Method (WWM)

The WWM compares the projected cash flows of a business “with” the intangible asset in place versus “without” it. The difference in cash flow over the forecast period is attributed to the value of the intangible assets. Useful when valuing non-separable intangible assets such as licenses, proprietary software, or customer contracts especially where the asset materially impacts business performance.

Steps:

1. Develop two sets of financial projections: one with the intangible asset (baseline) and one without (hypothetical).
2. Calculate the difference in cash flows between the two scenarios.
3. Adjust for taxes if required.
4. Discount the differential cash flows to present value at a suitable rate.

Example:

A company projects cash flows of NPR 50 million with a government license in place. Without the license, the business would generate only NPR 35 million due to lost access to certain markets. The difference of NPR 15 million (post-tax) over 5 years, discounted at 14%, reflects the value of the license.

9.3 Cost-Based and Market-Based Methods

When income-based valuation is not feasible due to lack of reliable future cash flow estimates other approaches can be considered.

a. Cost-Based Approach

This method estimates the value based on the cost to recreate or replace the asset. It includes all costs that would be incurred to reproduce the asset with similar functionality, adjusted for obsolescence. It is commonly used for internally developed software or technical documentation.

Example:

If it took NPR 10 million in salaries and design work over two years to develop proprietary software, and a modern version would cost NPR 12 million today, then replacement cost may be taken as NPR 12 million (subject to functional adjustments). Similarly, value of software would be NPR 10 million in cost model.

Note: Cost does not necessarily equal value but may provide a reasonable proxy in absence of market-based data.

b. Market-Based Approach

This method relies on actual market transactions of similar intangible assets. It is best suited when active markets or reliable pricing data exist such as software licenses, broadcast rights, or pharmaceutical patents. In Nepal's context, this approach is rarely applicable due to limited disclosure and low frequency of such transactions.

9.4 Brand, Trademark and Goodwill Valuation

Trademarks and brands are typically valued using the relief from royalty method, particularly when associated revenues can be clearly identified. The royalty rate should be based on comparable licensing agreements or published royalty rate databases, with appropriate adjustments for asset strength, exclusivity, and geographic use.

Goodwill, on the other hand, is not directly valued unless acquired. In business combinations, goodwill is calculated as the excess of the purchase consideration over the fair value of net identifiable assets.

Illustration:

Purchase Price: NPR 150 million

Fair Value of Net Assets (including other intangibles): NPR 120 million

Goodwill = NPR 30 million



Internally generated goodwill is not recognized under NAS 38. However, its valuation may be relevant for internal strategic analysis or dispute resolution.

9.5 Valuation under Business Combinations (NFRS/NAS Requirements)

Under NFRS 3– Business Combinations, all identifiable intangible assets acquired in a business combination must be recognized separately from goodwill, provided:

- They are separable or arise from contractual/legal rights
- Their fair value can be measured reliably

Each asset must be valued as of the acquisition date, using the most appropriate method (typically relief from royalty, MPEEM, or cost-based). The valuation forms the basis for future amortization and impairment assessments and must be supported by a formal report.

For example, a customer list generating recurring income may be valued using MPEEM, while a patented product may be valued using a DCF model based on licensing potential.

9.6 Useful Life and Amortization Implications

Once recognized, intangible assets must be assigned a useful life either finite or indefinite:

- Finite Life: Amortized over the estimated period of benefit, typically on a straight-line basis unless another method better reflects usage.
- Indefinite Life: Not amortized but tested annually for impairment.

Factors affecting useful life include:

- Legal/contractual term
- Economic obsolescence
- Technological changes
- Market or competitive conditions

Example:

A 5-year software license is amortized over 5 years.

A brand with sustained market recognition and legal protection may be considered to have an indefinite life (subject to periodic impairment testing under NAS 36).

Goodwill is always considered to have an indefinite life and is tested for impairment annually or more frequently if indicators of impairment exist.

9.7 Valuation of Goodwill

Goodwill represents the excess of the consideration transferred in a business combination over the net fair value of the identifiable assets and liabilities acquired. It reflects the intangible advantages of a business such as established customer relationships, brand reputation, skilled workforce, and expected synergies. As per NFRS 3 – Business Combinations, goodwill is recognized only when it arises from a business combination and is subject to annual impairment testing under NAS 36 – Impairment of Assets. Goodwill is not amortized, but regularly assessed for impairment, especially where it forms a material portion of the acquirer's balance sheet.

9.7.1 Goodwill Valuation Approaches

Valuation of goodwill can arise in multiple contexts: acquisition pricing, impairment testing, internal business restructuring, or dispute resolution. While goodwill itself is not typically valued in isolation, its value can be inferred using the following methods:

a. Excess Earnings Method (EEM)

This income-based method estimates goodwill as the present value of earnings exceeding a normal return on tangible and identifiable intangible assets. The steps involved are:

- Determine normalized earnings of the business.
- Deduct a fair return (using WACC) on identified tangible and intangible assets.
- The residual represents excess earnings, attributable to goodwill.
- Capitalize or discount this stream to arrive at the goodwill value.

Example: If normalized net earnings are NPR 15 million, and NPR 10 million is the required return on assets, then NPR 5 million is excess earnings. Discounted at 12%, goodwill = $\text{NPR } 5\text{M} / 12\% = \text{NPR } 41.67 \text{ million}$.

b. Residual Method (Purchase Price Allocation)

Used primarily in business combinations. Goodwill is measured as a residual:

Goodwill = Purchase Price – Net Identifiable Assets (at fair value)

This is consistent with NFRS 3 and IVS 210 (Intangible Assets). It reflects synergies or buyer-specific premiums that cannot be attributed to other assets.

Example: Consideration transferred = NPR 150M; fair value of net assets = NPR 120M → Goodwill = NPR 30M

9.7.2 Key Factors Influencing Goodwill Valuation

Valuers should consider the following while estimating or testing goodwill:

- Earnings potential and historical profitability trends.
- Synergies expected from the business combination (cost savings, market expansion, vertical integration).
- Barriers to entry, competitive advantage, and strategic importance.
- Reliability of forecasts, quality of management, and customer base.
- Marketability and transferability of the goodwill in standalone form (often not separable).

9.7.3 Goodwill Impairment under NAS 36

For financial reporting, NAS 36 requires that goodwill must be tested for impairment at the level of Cash-Generating Units (CGUs) to which it is allocated. If the recoverable amount of the CGU is less than its carrying amount (including goodwill), an impairment loss is recognized. Valuers may assist in:

- Estimating the recoverable amount using higher of its value-in-use or fair value less cost of disposal.
- Supporting assumptions such as discount rates, growth rates, and future cash flows.



9.7.4 Documentation Requirements

- Clear description of methodology and rationale for selection.
- Key assumptions, source of earnings/cash flows, and calculation of returns.
- Identification and valuation of other intangibles separately from goodwill.
- Use of external experts (if any) and their credentials.
- Disclosure of applicable NFRS/IVS references and compliance measures.

9.8 Conclusion

Valuing intangible assets involves careful identification, appropriate selection of valuation methods, and sound professional judgment. Given their non-physical nature, the use of income-based methods such as relief from royalty or excess earnings is common, but requires reliable data and robust assumptions. Cost and market approaches may also be applied where applicable.

In financial reporting and business combinations, compliance with NFRS/NAS is essential, particularly regarding recognition criteria, fair value measurement, and amortization or impairment treatment. Professional Accountants must ensure that valuations are well-supported, transparent, and aligned with both regulatory requirements and the intended purpose of the valuation.

Valuation of Equity Shares and Preference Shares

Valuation of equity and preference shares is a fundamental aspect of corporate finance, often required for regulatory compliance, investment decisions, mergers and acquisitions, financial reporting, and dispute resolution. Unlike tangible assets, shares represent ownership interests that derive value from a company's earning potential, asset base, and market position. The valuation process must consider the nature of the shares, rights attached, and the underlying business fundamentals.

In the Nepalese context, where many companies are closely held or unlisted, professional accountants are often required to apply judgment-driven approaches using a combination of income, market, and asset-based methods. This chapter outlines practical frameworks, regulatory considerations, and methodological guidance for valuing both equity and preference shares in line with best practices and ICAN expectations.

10.1 Equity Share Valuation Approaches

The valuation of equity shares is a core component of business valuation and is relevant for various purposes including mergers and acquisitions, shareholder disputes, financial reporting, regulatory compliance, and fund-raising. The selection of an appropriate valuation approach depends on the purpose of valuation, the nature of the entity, availability of data, and the specific rights attached to the shares.

The primary approaches used in valuing equity shares are:

- a. **Asset-Based Approach:** Focuses on the value of the net assets owned by the company after revaluing assets and liabilities to their fair values.
- b. **Income Approach:** Estimates the value of equity based on future earnings or cash flows attributable to shareholders, discounted to present value.
- c. **Market Approach:** Derives value by benchmarking against comparable listed companies or precedent transactions.

Professional judgment is essential in determining the appropriate method and assigning weight where multiple approaches are used.

10.2 Adjusted Book Value and Net Asset Value Methods

Under the Asset-Based Approach, the Adjusted Net Asset Value (ANAV) or Net Asset Value (NAV) method is used to estimate equity value by adjusting the book values of assets and liabilities to reflect their fair market values.

Equity Value = Fair Value of Total Assets – Fair Value of Total Liabilities

$$\text{Value per Share} = \frac{\text{Equity Value}}{\text{Number of Outstanding Shares}}$$



Example:

Fair value of total assets = NPR 600 million

Fair value of total liabilities = NPR 380 million

Number of outstanding shares = 1.1 million

Equity Value = NPR 220 million

Value per share = NPR 200

This method is particularly suitable for:

- Investment holding companies
- Real estate entities
- Companies undergoing liquidation or restructuring
- Dormant or asset-rich businesses with limited earnings

It may not be suitable for going concern entities with significant intangible value or growth prospects that are not reflected in book values.

10.3 Earnings-Based and Market-Based Approaches

These approaches are widely used for operating companies with regular income streams and access to market or peer data.

a. Earnings-Based Approaches

Capitalization of Earnings: This method assumes future maintainable profits are capitalized using a risk-adjusted capitalization rate.

$$\text{Equity Value} = \frac{\text{Maintainable Earnings}}{\text{Capitalization Rate}}$$

Example:

Maintainable PAT = NPR 20 million; Cap rate = 15%

$$\text{Equity Value} = \frac{20,000,000}{0.15} = \text{NPR 133.33 Million}$$

Discounted Cash Flow (DCF) Method: Projects future free cash flows to equity and discounts them using the cost of equity to derive the present value of equity. This method is particularly relevant for:

- Growth-stage companies
- Capital-intensive businesses
- Entities with variable earnings

b. Market-Based Approaches

Comparable Company Analysis (CCA): Derives value by applying valuation multiples (e.g., P/E, EV/EBITDA) of peer listed companies.

Precedent Transaction Analysis (PTA): Uses valuation multiples from past transactions in similar companies. Appropriate adjustments must be made for deal size, control premium, and timing.

These approaches depend on availability of reliable data and must consider size, liquidity, industry, and market conditions.

10.4 Valuation of Startups and Unlisted Companies

Valuing startups and unlisted companies involves dealing with limited financial history, higher uncertainty, and lack of market-based benchmarks. The following methods are commonly adopted:

DCF with Scenario Analysis: Cash flows are forecast under different scenarios (e.g., optimistic, base, and downside), with probabilities assigned to each.

Venture Capital Method: Projects the company's value at a future exit event (e.g., IPO, acquisition), and discounts the terminal value using a high target IRR reflecting investor expectations.

Example:

Expected Exit Value = NPR 1 billion in 5 years

Target IRR = 35%

$$\text{Present Value} = \frac{1,000,000,000}{(1 + 0.35)^5} = \text{NPR}223.01 \text{ million}$$

First Chicago Method, Scorecard Method, or Berkus Method may also be used in early-stage startups, blending qualitative and quantitative indicators.

Use of qualitative factors such as strength of the founding team, scalability, and competitive positioning is common, but should be supported with transparent assumptions and industry benchmarks.

10.5 Rights, Preferences and Restrictions on Shares

The rights and restrictions associated with equity shares can significantly affect their value. These include:

- a. **Voting Rights:** Voting shares often carry a control premium, especially if they confer significant influence or decision-making authority.
- b. **Dividend Entitlements:** Shares with fixed or preferential dividend rights may warrant higher valuation.
- c. **Transfer Restrictions:** Lock-in periods, first refusal rights, or tag/drag-along clauses may reduce liquidity and value.
- d. **Liquidation Preferences:** Certain classes may have priority over common shareholders during liquidation, enhancing or diminishing value depending on capital structure.



In such cases, appropriate discounts or premiums must be applied. The company's Articles of Association, shareholder agreements, and issuance documents must be reviewed carefully to understand and quantify these rights.

10.6 Valuation of Preference Shares (Redeemable/Irredeemable)

Preference shares combine characteristics of both equity and debt, and their valuation depends on the terms of issuance.

a. Redeemable Preference Shares

These are valued as fixed-income instruments by discounting the expected stream of dividend payments and the redemption value.

Example:

Annual Dividend = NPR 80

Redemption after 5 years at NPR 1,000

Discount Rate = 10%

$$\text{Value} = \sum_{t=1}^5 \frac{80}{(1 + 0.10)^t} + \frac{1000}{(1 + 0.10)^5} = \text{NPR } 924.18$$

b. Irredeemable Preference Shares

These are valued as perpetuities, based on annual dividend and required rate of return.

$$\text{Value} = \frac{\text{Annual Dividend}}{\text{Cost of Preference Capital}}$$

Example:

Dividend = NPR 100

Required Return = 9%

Value = $100 / 0.09 = \text{NPR } 1,111.11$

c. Convertible Preference Shares

These require bifurcation between:

Debt Component (present value of dividends and redemption)

Equity Option (value of conversion feature using option-pricing or comparable equity)

The total value is the sum of both components, adjusted based on the likelihood of conversion.

Valuation of preference shares must also consider their rank in capital structure, cumulative/non-cumulative nature, and enforceability of terms.

10.7 Valuation of Digital Assets and Tokenized Securities

Digital assets such as cryptocurrencies, utility tokens, and tokenized equity are gaining traction in investment and corporate finance. Due to their unique structure, valuation often depends on available market inputs (where active exchanges exist) or modeled assumptions.

Market Price Method: Used for widely traded assets like Bitcoin, Ethereum (Level 1 input).

Income Approach: Applied where yield-generating mechanisms (e.g., staking) exist.

Challenges: Volatility, lack of regulatory clarity in Nepal, storage risk, and limited financial history.

Professional accountants must exercise heightened due diligence, verify custodianship, and disclose risk factors explicitly in valuation reports.

Currently, based on the notice published by Nepal Rastra Bank any investment in Bitcoin, Alt Coin, Tokenized assets and such digital assets is illegal in Nepal and should not be done.

10.8 Valuation of Shares in the Context of Fair Value Hierarchy and NFRS Classification

Valuation of equity and preference shares must be undertaken with due consideration of NFRS 13: Fair Value Measurement, especially where the valuation is for the purposes of financial reporting under NFRS or IFRS. This requires the classification of the valuation technique and inputs used under the three-level fair value hierarchy.

10.8.1 Listed Shares (Level 1 Inputs)

For equity shares that are publicly traded on an active exchange, the fair value is typically derived directly from quoted market prices at the valuation date. These are classified as Level 1 inputs under NFRS 13. No adjustments are generally required unless there are restrictions on transferability or abnormal market conditions.

Example: Shares of NABIL Bank Ltd. quoted on NEPSE at NPR 1,200 per share as of the valuation date would be classified as Level 1 and valued at the quoted price.

10.8.2 Unlisted Shares (Level 2 and Level 3 Inputs)

For unlisted equity shares, observable market data is limited or unavailable. Valuation must then rely on:

Level 2 Inputs: Multiples derived from comparable listed companies, adjusted for size, liquidity, and control factors (e.g., P/E, EV/EBITDA).

Level 3 Inputs: Entity-specific forecasts, DCF models, and adjusted net asset value, which rely heavily on unobservable inputs and professional judgment.

Example: Valuation of a 100% stake in XYZ Pvt. Ltd. using the DCF approach with cash flow projections and a risk-adjusted discount rate falls under Level 3.

10.8.3 Preference Shares and Convertible Instruments

Preference shares and hybrid financial instruments may have debt- or equity-like characteristics. Their classification and valuation depend on their contractual terms and market observability:

Redeemable Preference Shares: Typically valued using a discounted cash flow method for fixed dividends and redemption amount.

ESOPs: Valued considering vesting conditions, volatility, and time to maturity, usually under Level 3.

Valuers must clearly state the level of the fair value hierarchy used and provide supporting rationale for input selection, assumptions, and any adjustments made.

10.8.4 Disclosure and Documentation

In cases where fair value is reported for financial statements, disclosures must include:

- The level of the fair value hierarchy (1, 2, or 3).
- The valuation technique applied and justification.
- Key unobservable inputs (for Level 3), including ranges and sensitivity.
- Any external expert work relied upon.

10.9 Conclusion

Valuing equity and preference shares requires a balanced application of income, market, and asset-based approaches, tailored to the characteristics of the underlying entity and the specific rights attached to the securities. For equity shares, factors such as control, liquidity, growth potential, and industry positioning are central to determining fair value. For preference shares, features such as redemption terms, dividend priority, and convertibility must be carefully analyzed.

In the Nepalese environment, where many companies are privately held and market data is limited, professional accountants must exercise sound judgment, apply reasonable assumptions, and document their rationale with diligence. Whether for regulatory filings, internal decision-making, or transaction structuring, a well-reasoned valuation supports transparency, consistency, and investor confidence.

Valuation of Bonds and Debentures

11.1 Overview

Bonds and debentures are fixed-income instruments that represent contractual obligations of an issuer to pay interest and repay principal at maturity. These instruments can be traded or privately held and are often used in corporate finance, investment portfolios, and restructuring contexts. Their valuation must reflect the time value of money, credit risk, and market conditions, in accordance with NFRS 9 (Financial Instruments) and NFRS 13 (Fair Value Measurement).

While listed instruments may provide market-based prices (Level 1 inputs), unlisted or infrequently traded bonds and debentures require valuation using observable inputs (Level 2) or models incorporating significant judgment (Level 3).

11.2 Types of Instruments

Instrument Type	Key Features
Straight Bond	Fixed coupon, fixed maturity, no embedded features
Zero-Coupon Bond	Issued at a discount, no periodic interest
Floating Rate Bond	Interest tied to benchmark (e.g., base rate + spread)
Convertible Debenture	Hybrid security with equity conversion option
Perpetual Bond	No maturity date, fixed or variable coupon

11.3 Valuation Methodologies

11.3.1 Discounted Cash Flow (DCF) Method

The most common method for valuing fixed-income securities is the DCF approach. It involves projecting the future coupon payments and the redemption value and discounting them at an appropriate yield reflective of the market and credit profile.

$$\text{Bond Value} = \sum_{t=1}^n \frac{C}{(1+r)^t} + \frac{F}{(1+r)^n}$$

Where:

C = periodic coupon payment

F = face value or redemption amount

r = market yield or required rate of return

n = number of periods to maturity



Example:

A debenture with a face value of NPR 1,000, coupon rate of 8%, 5 years to maturity, and market yield of 9% would have its cash flows discounted at 9% to estimate fair value.

11.3.2 Yield to Maturity (YTM) Method

Where market data is available, YTM represents the internal rate of return equating the bond's future cash flows to its current market price. This method is typically used for listed or frequently traded instruments.

Note: The YTM also informs the discount rate selection for DCF where direct market prices are not observable.

11.3.3 Zero-Coupon Bond Valuation

Zero-coupon bonds provide no periodic interest but are issued at a deep discount. Their valuation is based solely on the present value of the maturity value:

$$\text{Value} = \frac{F}{(1 + r)^n}$$

11.3.4 Convertible Debentures

Convertible debentures require a bifurcated approach:

Debt Component: Valued using DCF of fixed coupon and principal payments.

Equity Component (Option): Valued using Black-Scholes or Binomial model depending on conversion terms.

This method aligns with NFRS 9's requirement to separate and value embedded derivatives where applicable.

11.4 Key Valuation Inputs

Input	Description
Discount Rate	Based on comparable market yields for similar credit ratings and maturities
Credit Risk Premium	Adjustment for issuer's creditworthiness
Liquidity Discount	Applied for unlisted or infrequently traded bonds
Currency Risk	Incorporated where cash flows are denominated in foreign currencies
Embedded Features	Call/put options, step-up coupons, or conversion rights are separately valued

11.5 Practical Considerations

Documentation: Review debenture trust deeds, term sheets, and listing documents to understand cash flow structure and embedded terms.

Market Inputs: Use observed yields from government securities, credit spreads, and similar corporate bonds.

Expert Inputs: For complex features (e.g., convertibility), consult financial modelers or actuaries.

Regulatory Compliance: Align valuation with classification and measurement requirements under NFRS 9, particularly for fair value through profit or loss (FVTPL) instruments.

11.6 Fair Value Hierarchy Alignment

Level 1: Quoted market prices for identical instruments (e.g., listed bonds).

Level 2: Observable market inputs like benchmark yields or credit spreads.

Level 3: Unobservable inputs requiring significant professional judgment.

Professional accountants must disclose the hierarchy level used and justify the valuation approach in their report.

11.7 Conclusion

The valuation of bonds and debentures involves assessing the expected future cash flows and discounting them at market-consistent rates. Professional accountants must understand the terms of the instrument, evaluate market comparability and apply appropriate valuation models based on data availability and complexity. Clear documentation, adherence to NFRS, and reliance on expert input where necessary are critical for defensible and consistent valuation outcomes.

Valuation of Options and Complex Securities

Options and other complex securities represent contingent or derivative claims on the value of a business. Their valuation requires specialized methodologies that account for uncertainty, volatility, and time-dependent payoffs. Instruments such as employee stock options (ESOPs), convertible debentures, warrants, and embedded derivatives often have features that cannot be valued using traditional income or market approaches alone.

The growing use of structured financial instruments in private equity, capital market offerings, and employee compensation plans has made it increasingly important for professional accountants to understand the principles and models applicable to their valuation. This chapter outlines the theoretical foundations, key models, and practical considerations involved in valuing such instruments.

12.1 Types of Derivatives and Embedded Instruments

Options and complex securities include financial instruments whose value depends on underlying assets and contractual terms, often involving contingent or variable returns. These instruments may be stand-alone or embedded within other financial contracts. Their valuation requires a blend of financial theory, quantitative modeling, and professional judgment. Common types include:

Options: Call or put options granting the holder the right (but not obligation) to buy or sell an asset at a pre-determined price.

Warrants: Long-term instruments issued by a company giving the holder the right to purchase shares at a specified price.

Convertible Debentures: Hybrid securities allowing bondholders to convert their debt into equity under defined conditions.

Employee Stock Option Plans (ESOPs): Options granted to employees as part of compensation, often subject to vesting and performance hurdles.

Embedded Derivatives: Option-like components within host contracts (e.g., early call options in bonds, conversion features in preference shares).

Accounting for such instruments under NFRS 9 and NFRS 2 often requires fair valuation using option-pricing techniques, especially where instruments are measured at fair value through profit or loss.

12.2 Option Pricing Models (Black-Scholes, Binomial, Monte Carlo)

Valuing options and embedded derivatives requires quantitative modeling based on the probabilistic nature of payoffs. The commonly used models are:

a. Black-Scholes Model

The Black-Scholes Model is one of the most widely used tools for valuing European-style options i.e., options exercisable only at expiration. Developed by Fischer Black and Myron Scholes, this model provides a theoretical estimate of the fair value of a call or put option based on key market inputs. It is particularly useful for valuing listed stock options, warrants, and employee stock options with simple exercise features.

b. Binomial Model

Suitable for American-style options (exercisable any time before maturity), the binomial model uses a tree-based approach to simulate multiple price paths over discrete time intervals. It allows flexibility to incorporate early exercise features, dividends, and varying volatility.

c. Monte Carlo Simulation

This model simulates a large number of random price paths based on probabilistic assumptions and calculates average payoffs, discounted to present value. It is used for complex instruments with path-dependent features (e.g., barrier options or market-linked debentures).

While these models provide theoretical precision, the reliability of outcomes depends on the quality of inputs particularly volatility assumptions, discount rates, and expected term.

12.3 Valuation of Convertible Debentures, Warrants and ESOPs

a. Convertible Debentures

These hybrid instruments combine debt-like fixed returns with an equity conversion option. Valuation involves separating and valuing:

- The debt component (using discounted cash flow of coupons and redemption)
- The conversion option (using option pricing models)

b. Warrants

Valued similarly to options using Black-Scholes or binomial models. The dilution impact and terms such as exercise period and strike price must be considered.

c. Employee Stock Options (ESOPs)

Under NFRS 2, ESOPs are recognized at fair value on the grant date using an option pricing model. The valuation must consider:

- Grant date fair value
- Exercise price
- Vesting period and conditions
- Employee turnover expectations
- Expected volatility and dividend yield

12.4 Adjustments for Dilution and Vesting Conditions

Valuation of complex securities must incorporate potential dilution effects, especially for instruments convertible into equity. The fully diluted basis of equity must be considered when deriving per-share value or enterprise value.

Additionally, vesting conditions (service or performance-based) affect the valuation and accounting treatment of ESOPs:

Non-market conditions (e.g., continued employment) do not affect fair value but impact expense recognition.

Market conditions (e.g., stock price target) are factored into the fair value using adjusted models.

Discounts for lack of marketability or restrictions on transferability may also be considered where applicable.

12.5 Use of Specialist Valuers and Collaboration Considerations

Valuation of options and complex securities often requires specialized quantitative expertise. Professional Accountants may need to collaborate with:

- Actuarial professionals
- Quantitative finance specialists
- External valuation consultants

While delegating the technical modeling, the Professional Accountants remains responsible for:

- Assessing the reasonableness of assumptions
- Evaluating the credibility of the model outputs
- Ensuring consistency with applicable accounting standards and purpose of valuation

Professional skepticism, robust documentation, and adequate disclosures in the valuation report are essential when relying on specialist inputs.

12.6 ESG Adjustments in Valuation

ESG considerations can materially affect a company's value, either through operational efficiencies (positive) or through exposure to regulatory and reputational risks (negative). Valuers may incorporate ESG by:

- Adjusting discount rates or risk premiums (e.g., for poor governance or environmental fines),
- Forecasting cash flow impacts of sustainability initiatives (e.g., energy savings),
- Applying premiums for ESG leadership in high-impact sectors.

ESG scores or frameworks (e.g., Global Reporting Initiatives (GRI), Sustainability Accounting Standards Board (SASB)) can support these adjustments, particularly for reporting or cross-border valuation engagements. While not yet mandatory under NFRS, ESG-linked disclosures are increasingly expected by international stakeholders.

12.7 Conclusion

Valuation of options and complex securities demands a sophisticated understanding of financial theory, mathematical modeling, and practical judgment. Instruments such as ESOPs, convertible debentures, and warrants often carry contingent features such as dilution, vesting conditions, and embedded options that significantly affect their value and risk profile.

Professional accountants must apply appropriate valuation models, such as Black-Scholes, Binomial, or Monte Carlo simulation, depending on the complexity of the instrument and the availability of data. Collaboration with actuaries, financial engineers, or valuation specialists may be essential for accuracy and compliance, particularly where regulatory or financial reporting requirements under NFRS are involved.

Incorporating these instruments into a broader valuation exercise also requires careful consideration of their impact on the capital structure, ownership dilution, and shareholder value. A disciplined and transparent approach ensures the resulting valuations are reliable, support informed decision-making, and align with ICAN's expectations of professional competence.

Common Adjustments & Normalization

Valuation requires a clear understanding of the true earning capacity and financial position of an entity. Reported financial statements may not always reflect this due to non-recurring, discretionary, or non-operational elements. To ensure comparability and to arrive at a fair and representative value, normalization and specific adjustments are applied by professional valuers.

13.1 Normalization of Financial Statements

Normalization involves adjusting the financial statements especially earnings and cash flows to reflect a company's sustainable, ongoing performance. These adjustments eliminate anomalies, one-time events, or accounting choices that distort economic reality.

Common normalization areas include:

- Excessive or below-market salaries to owners
- One-time litigation settlements
- Accounting estimate changes (e.g., depreciation policy)
- Unrealized foreign exchange gains/losses

The goal is to arrive at a set of financials that reflect maintainable earnings and are consistent with peer comparisons.

13.2 Non-Recurring and Non-Operating Items

Valuers must identify and exclude income or expenses that do not form part of the core operating performance. These may include:

Non-Recurring Items: Gains/losses from asset sales, disaster-related expenses, restructuring costs, IPO expenses.

Non-Operating Items: Income from investments unrelated to the business, rental income from surplus property, interest on surplus funds

Example:

A company reports profit of NPR 40 million, including NPR 6 million from sale of a factory and NPR 2 million from dividends on a one-off investment. Normalized earnings = NPR 40 million – 8 million = NPR 32 million

Only recurring, operational items should be used in the application of valuation multiples or cash flow projections.

13.3 Related Party Transactions and Management Compensation

Valuers should assess whether transactions with related parties are conducted at arm's length. Non-market terms may distort profitability or asset values. Areas to review include:

- Sales or purchases from group companies at inflated/deflated prices
- Interest-free loans to/from related parties
- Rent-free use of property
- Excessive or below-market director remuneration

Adjustments should reflect market-equivalent charges or benefits. For instance, if the managing director receives NPR 1.5 million whereas a market-aligned compensation is NPR 3 million, the underpaid amount should be adjusted when estimating maintainable earnings.

13.4 Working Capital Adjustments

Working capital adjustments are crucial when applying the DCF method or when estimating enterprise value. An entity may have abnormally high or low working capital due to seasonal effects, one-off changes, or inefficient management. Key points include:

- Ensure working capital is normalized to reflect a typical operating cycle.
- Exclude surplus cash and unrelated investments from enterprise value.
- For growing businesses, account for increasing working capital needs in projections.

Example:

If normalized working capital is 15% of sales but the current level is 10%, the model should incorporate the need to build up working capital over time, which reduces free cash flows.

13.5 Control Premium and Minority Discount

The value of shares differs based on whether the interest being valued carries control rights.

Control Premium: Applied when valuing a controlling stake; reflects the buyer's ability to direct strategic decisions, appoint management, or initiate restructuring.

Minority Discount: Applied when valuing a non-controlling interest; reflects limited influence and lack of control.

Example:

If 100% equity value is NPR 100 million and the control premium is 25%, a controlling interest may be valued at NPR 125 million. Conversely, a minority interest may be discounted by 15–25% depending on governance, dividend policy, and shareholder rights.

Valuers should apply these adjustments based on:

- Purpose of valuation (e.g., strategic sale vs. compliance)
- Degree of control inherent in the shareholding
- Legal and operational structure of the company

13.6 Triangulation and Reconciliation of Valuation Approaches

In many valuation assignments, especially where multiple valuation approaches (Income, Market, Asset-Based) are applied, it is important to reconcile the outcomes to arrive at a credible and defensible value conclusion. This process is known as triangulation.

Triangulation involves evaluating the results of different methods, understanding the reasons for divergence, and applying professional judgment to determine the most appropriate final value or range.

Key Principles:

Cross-Method Validation: Use different approaches as cross-checks. For example, DCF results may be validated against market multiples or NAV where applicable.

Method Weighting: Assign relative weights to each approach based on relevance, reliability of inputs, and nature of the business (e.g., Market Approach may carry higher weight in active sectors, while Asset Approach may dominate in holding companies).

Justification for Method Selection: Clearly document why certain methods were considered primary or secondary and the rationale for excluding others.

Reconciliation Statement: Summarize valuation conclusions, showing how the final estimate reflects triangulated reasoning. Include sensitivity ranges if material.

Example:

Suppose three valuation methods yield the following:

Income Approach (DCF): NPR 210 million

Market Approach (EV/EBITDA): NPR 225 million

Asset Approach (Adjusted NAV): NPR 190 million

After evaluating the business's earnings reliability and asset intensity, the valuer assigns 50% weight to DCF, 30% to Market, and 20% to Asset approach, arriving at:

Final Value = $(210 \times 0.5) + (225 \times 0.3) + (190 \times 0.2) = \text{NPR } 210.50 \text{ million}$

The final valuation report must disclose this reasoning and reconcile divergent outcomes in a transparent and logical manner.

13.7 Liquidity and Marketability Discounts

Lack of liquidity or market access may reduce the realizable value of a security, especially in the case of unlisted shares, ESOPs, or instruments with transfer restrictions.

- Liquidity Discount: Reflects the difficulty in selling an asset without impacting price.
- Marketability Discount: Arises when instruments are subject to lock-in, shareholder agreements, or regulatory restrictions.

Discounts typically range from 10% to 35%, depending on:

- Exit avenues available to shareholders
- Frequency of past share transfers
- Size of stake being valued
- Presence of buyer restrictions or exit covenants

Valuers should disclose the rationale and basis for any such discount, supported by empirical data, professional judgment, or market studies where available.

Documentation & Quality Control

Maintaining a robust system of documentation and internal quality control is fundamental to ensuring transparency, accountability, and professional credibility in valuation engagements. Documentation not only supports the conclusions reached but also demonstrates that the valuation was conducted in accordance with applicable standards, ethical principles, and due diligence expectations.

This chapter outlines the key documentation and quality control practices that Professional Accountants must follow while undertaking valuation assignments.

14.1 Required Documentation for Valuation Engagements

Valuation documentation must be sufficient to enable a knowledgeable third party, having no prior connection to the engagement, to understand the work performed, the assumptions applied, and the basis for conclusions reached. Key documents to retain include:

- Engagement letter and scope definition
- Company and industry background information
- Financial statements and adjustments made
- Valuation methodologies used and reasons for selection
- Assumptions (discount rate, growth rate, multiples, etc.)
- Data sources and justification
- Working papers and computation sheets
- Final valuation report

Proper documentation ensures transparency, supports audit/regulatory review, and protects against professional liability.

14.2 Engagement Letter and Scope Definition

A written engagement letter is essential for defining the scope, responsibilities, and expectations of both the valuer and the client. It provides legal and professional clarity and helps prevent misunderstandings. The engagement letter should clearly state:

- Purpose and objective of the valuation
- Identity of the client and subject entity
- Scope and limitations of work
- Type of value to be determined (e.g., fair value, liquidation value)
- Valuation date
- Deliverables and reporting format
- Timelines and fees
- Confidentiality and use restrictions

Changes to scope or objectives must be documented through amendments or supplementary letters.

14.3 Internal Review and Supervision

Effective internal supervision and review mechanisms are critical to maintaining the quality of valuation work. Firms must ensure:

- Senior-level review of all key assumptions and conclusions
- Cross-verification of inputs and computation models
- Adherence to standard templates and checklists
- Proper delegation, with supervision of junior team members
- Consistency across working papers and the final report

Before finalization, a technical review should be conducted to ensure compliance with valuation standards, regulatory expectations, and firm policies.

14.4 Use of Experts and Third-Party Inputs

Valuation engagements may require input from external experts or specialists such as actuaries, engineers, real estate valuers, or industry consultants.

When relying on third-party inputs:

- Assess the qualifications and independence of the expert
- Evaluate the reasonableness of assumptions and methods used
- Retain written reports or confirmations from the expert
- Disclose reliance on external inputs in the valuation report

The Professional Accountants remains ultimately responsible for the overall valuation and must exercise professional skepticism when incorporating external opinions or models.

14.5 Maintaining Audit Trail and Working Papers

A clear and complete audit trail must be maintained throughout the valuation process. This includes:

- All versions of working papers and calculations
- Correspondence and communication with the client
- Minutes of meetings or internal review discussions
- Documentation of changes in approach or assumptions
- Source data used for benchmarking or comparable

Working papers should be organized, dated, and referenced, allowing seamless traceability from raw data to final conclusions. Retention of working papers should comply with ICAN's record-keeping guidelines or the applicable regulatory framework (typically 7 years).

14.6 Disclosure of Material Valuation Uncertainty

In certain circumstances, the valuation conclusion may be significantly impacted by factors that create a high degree of estimation uncertainty. Professional accountants must evaluate whether such uncertainty

is material, and where appropriate, provide clear disclosures in the valuation report. Situations that may give rise to material valuation uncertainty:

Volatile Market Conditions: Sharp fluctuations in equity, commodity, or currency markets that affect asset pricing.

Illiquid or Distressed Assets: Assets for which there is no active market or recent transaction data.

Macroeconomic Instability: Events such as political turmoil, inflationary shocks, pandemics, or interest rate changes.

Limited or Unreliable Data: Incomplete financials, outdated third-party appraisals, or projections based on management assumptions lacking support.

Significant Reliance on Level 3 Inputs: Use of unobservable inputs in accordance with NFRS 13 and IVS 104.

Disclosure Requirements:

- Clearly state in the report that **material valuation uncertainty exists**.
- Describe the nature of the uncertainty (e.g., “The market for comparable real estate remains inactive due to current geopolitical instability.”)
- Indicate the **potential impact** on the valuation conclusion.
- Where feasible, present **sensitivity analysis** or a range of values to reflect such uncertainty.
- State that the valuation should be **interpreted with caution** under current conditions and may need to be updated when uncertainty subsides.

Illustrative Disclosure:

“This valuation has been prepared during a period of significant economic disruption due to [..... event], resulting in a lack of observable market data. As a result, there is material uncertainty associated with certain inputs, particularly market rental rates and capitalization rates. Accordingly, the valuation conclusion should be interpreted with caution, and users are advised to consider the accompanying sensitivity analysis.”

14.7 Risk Management and Peer Review Practices

Valuation engagements carry reputational and professional risk, particularly in high-stakes contexts such as litigation, regulatory filings, or corporate transactions. Professional Accountants are encouraged to establish internal risk management protocols, including:

- Conflict checks and client due diligence
- Documentation of key judgment areas
- Use of disclaimers and limiting conditions
- Legal vetting of valuation reports where necessary

Peer review either within the firm or through external technical reviewers can serve as a valuable risk mitigation tool, particularly for complex or sensitive assignments. It enhances credibility and provides assurance on technical robustness.

Specimen of Valuation Reports to Members of ICAN

Valuation reports are formal deliverables that communicate the professional accountant's opinion of value, supporting rationale, assumptions, and methodology to stakeholders. A well-structured valuation report enhances transparency, promotes consistency, and provides users with sufficient information to understand the basis of the valuation. ICAN recognizes the need for a standardized reporting framework to ensure the credibility, reliability, and professional quality of valuation opinions issued by its members.

This chapter outlines the recommended structure, disclosures, and professional requirements applicable to valuation reports prepared by members of ICAN, in alignment with applicable laws, standards, and ethical obligations.

15.1 Structure and Format of Valuation Report

While the structure of the report may vary depending on the purpose and complexity of the valuation, a professionally prepared report should generally include the following sections:

1. **Cover Page:** Title of the report, date, name of the client, and valuer's name and designation.
2. **Executive Summary:** The executive summary provides an overview of the valuation engagement and highlights key conclusions. It should include:
 - **Purpose of the valuation:** Clearly state the purpose for which the valuation is being conducted.
 - **Scope of work:** Outline the extent of the work performed, including limitations and assumptions.
 - **Valuation conclusion:** Summarize the key findings, including the final estimated value of the asset, business, or financial instrument.
 - **Date of valuation:** Mention the date as of which the valuation is valid.

Example: The purpose of this valuation is to determine the fair value of XYZ Private Limited as of January 1, 2024, for potential acquisition purposes. After considering all relevant factors, we estimate the fair value of the company to be NPR 250 million.

3. **Introduction and Background:** This section sets the context for the valuation assignment. It should include:
 - The purpose of the valuation (e.g., financial reporting, transaction advisory, regulatory submission, litigation support, internal assessment).
 - A brief description of the subject asset or entity, including its nature, ownership structure, and operational background.
 - The regulatory context, if applicable, such as requirements under NFRS, Companies Act, or directives issued by NRB, SEBON, or NIA.
 - This section helps the reader understand why the valuation was undertaken and the nature of what is being valued.

4. Scope and Limitations: Define the scope of the engagement and if there are any limitation related to the assignment same shall also be mentioned clearly, stating:

- What specifically has been valued (e.g., equity shares, intangible asset, business unit).
- The valuation date and the reporting date, if different.
- Any limitations or constraints encountered during the engagement, such as unavailability of audited financials, restricted access to management or site visits, or use of management projections without independent verification.
- Any exclusions, such as specific liabilities, contingent assets, or environmental risks not considered in the scope.
- This section is essential for setting expectations and managing risk for both the valuer and users of the report.

5. Methodologies and Approaches Applied: Detailed explanation of valuation approaches considered, rationale for selection, and computational analysis. Provide a detailed discussion on:

- The valuation approaches considered (Income, Market, or Asset-Based).
- The rationale for selecting the chosen method(s) based on the subject asset's characteristics, data availability, and valuation purpose.
- A description of key steps and computations, including:
 - » Cash flow projections (for DCF)
 - » Market multiples (for Comparable Company or Transaction Analysis)
 - » Asset adjustments (for NAV or liquidation value)
- Any cross-validation with secondary methods, if applied.

This section must demonstrate the technical soundness and analytical rigor behind the value conclusion.

6. Assumptions and Disclaimers: Disclose all critical assumptions used in the valuation, including:

- Financial forecasts, growth rates, discount/capitalization rates, terminal value assumptions, or asset condition.
- Sources of information relied upon (e.g., management data, audited financials, third-party valuation reports).
- Limitations of the analysis such as market volatility, non-verification of legal title, or lack of due diligence on operational matters.
- Disclaimers help protect the professional accountant from undue liability while ensuring transparency of scope boundaries.

7. Conclusion of Value: This section must be concise, defensible, and easily understood by both technical and non-technical stakeholders. Summarize the final opinion of value, including:

- The valuation conclusion (point estimate or range), clearly presented in both words and figures.

- Any material adjustments made to arrive at the final value (e.g., control premium, minority discount, liquidity adjustment).
 - A brief narrative supporting the conclusion, linking back to the methodology and assumptions used.
- 8. Annexures:** Annexures provide transparency and auditability to the valuation report. Attach relevant supporting documentation, including:
- Detailed financial models and working tables
 - Benchmarking analysis, such as peer multiples or industry data
 - Valuation of underlying assets or investments, if applicable
 - Copies of key documents relied upon (e.g., third-party reports, management representations)
 - Any legal or regulatory references that substantiate the basis of value

Valuation reports should be written in clear and professional language, with logically organized sections, proper headings, and consistent formatting. The goal is to ensure that the report is comprehensible not only to valuation professionals but also to business users, regulators, investors, and auditors who may not possess technical valuation expertise.

15.2 Mandatory Disclosures

To ensure transparency, every valuation report must include the following mandatory disclosures:

- Purpose of valuation (e.g., financial reporting, regulatory, dispute resolution)
- Valuation date (as of which the value is assessed)
- Basis of value (e.g., fair value, liquidation value, investment value)
- Standard of value and premise of value applied
- Information relied upon, and its source (audited financials, management data, external research)
- Any material assumptions or estimates that have a significant effect on value
- Sensitivity or risk analysis (if performed)
- Use restrictions, if applicable (e.g., for client use only)

Failure to include such disclosures can lead to misinterpretation or misuse of the report.

15.3 Statement of Assumptions and Limiting Conditions

Every valuation involves certain assumptions and boundaries within which the valuation exercise is conducted. A well-articulated statement of assumptions and limiting Conditions is a critical safeguard for the valuer. Typical disclosures include:

- Reliance on unaudited or management-provided information
- Assumption of going concern or continuity of business
- Exclusion of legal or environmental due diligence
- No physical verification of assets unless stated
- No responsibility for events occurring after the valuation date



Such statements protect the valuer from liability arising from factors beyond the agreed scope of engagement or from reliance on incomplete or inaccurate data.

15.4 Compliance with NAS/NFRS and Valuation Standards (as applicable)

Valuation reports prepared for financial reporting or regulatory filings must clearly disclose compliance with:

- Nepal Accounting Standards (NAS)/Nepal Financial Reporting Standards (NFRS), particularly where fair value measurement (e.g., NFRS 13) or business combinations (e.g., NFRS 3) are involved.
- Valuation Manual issued by ICAN and internationally adopted valuation standards (if any) or other sectoral benchmarks, where relevant.
- Any specific instructions or formats prescribed by regulators (e.g., SEBON, IRD, NRB, NIA).

Valuers must clearly indicate the framework followed and demonstrate consistency with applicable accounting and valuation principles.

15.5 Disclosure of Valuer's Credentials and Independence

The valuation report must include a declaration stating:

- The name, designation, and ICAN membership number of the valuer
- Relevant qualifications and experience of the valuer in the subject matter
- Confirmation of independence from the client and subject entity
- Disclosure of any potential conflict of interest
- Statement of compliance with ICAN's Code of Ethics for Professional Accountants

This enhances the credibility of the report and reassures users about the integrity of the valuation process.

15.6 Conclusion

A well-structured valuation report is essential to convey the credibility, transparency, and technical soundness of the valuation exercise. For Professional Accountants, adherence to a consistent reporting format, inclusion of required disclosures, and alignment with applicable standards not only uphold professional integrity but also enhance stakeholder confidence. As valuation engagements vary in scope and complexity, the report must clearly communicate the methodology, assumptions, limitations, and the valuer's credentials. By following the Manual set forth by ICAN, members can ensure uniformity, regulatory compliance, and high-quality deliverables across all valuation assignments.

Annexure

Sample Valuation Report

Below is a detailed example of a valuation report for ABC Manufacturing Company, based on the Manual outlined in Chapter 15. This report is structured in accordance with the International Valuation Standards (IVS) and the ethical principles of the Institute of Chartered Accountants of Nepal (ICAN).

Valuation Report

Subject: Valuation of ABC Manufacturing Company

Prepared by: XYZ Chartered Accountants

Valuer: Mr. Name of Professional, CA

Date of Report: February X, 202X

Valuation Date: January X, 202X

Report Reference: XYZ/VAL/202X/001

1. Executive Summary

Purpose of Valuation:

This report has been prepared to estimate the fair value of a 100% equity interest in ABC Manufacturing Company ("ABC" or "the Company") as of January X, 202X, for the purpose of facilitating a potential acquisition by XYZ Private Limited.

Basis and Premise of Valuation

The valuation has been carried out on a fair value basis, assuming that the Company will continue to operate as a going concern. The valuation does not assume liquidation, forced sale, or distress sale of the Company.

Scope of Work:

The valuation has been performed based on the information provided by management, including historical financial statements, management projections, details of assets, and other relevant business information. The valuation has considered the following approaches:

1. Income Approach - Discounted Cash Flow Method
2. Market Approach - Comparable Companies Method
3. Asset Approach - Adjusted Net Asset / Replacement Cost Method

Valuation Conclusion:

Based on the analysis performed and subject to the assumptions and limitations stated in this report, the fair value of 100% equity interest in ABC Manufacturing Company as at January X, 202X is estimated at NPR 190 Million.

2. Engagement Details

Engagement Terms:

XYZ Chartered Accountants was engaged by XYZ Private Limited to provide an independent valuation of ABC Manufacturing Company for acquisition assessment purposes.

The valuation has been prepared solely for the intended use of XYZ Private Limited and should not be used for any other purpose without prior written consent of XYZ Chartered Accountants

Valuer's Independence:

The valuer confirms that he has no financial interest in ABC Manufacturing Company or XYZ Private Limited. The valuation has been conducted independently, objectively, and without any contingent fee arrangement linked to the valuation conclusion.

3. Subject of the Valuation

Description of the Business:

ABC Manufacturing Company is a private limited company based in Kathmandu, Nepal, operating in the textile manufacturing sector. Established in 2010, the company produces a range of fabric and garment products for both domestic and export markets.

Ownership Interest Valued:

This valuation pertains to a 100% equity stake in ABC Manufacturing Company, which is currently owned by the founding shareholders.

Financial and Operational Performance:

The company has reported consistent revenue growth over the past three years, driven by increasing demand for its products in both domestic and export markets. Key financial figures for the last three fiscal years are as follows:

Fiscal Year	Revenue NPR (in million)	Net Profit NPR (in million)
2021	150	12
2022	180	14.5
2023	220	18

4. Valuation Approaches and Methodologies

Income Approach (Discounted Cash Flow Method):

The Discounted Cash Flow (DCF) method was applied to project ABC's future cash flows over the next five years, discounting them to present value using a Weighted Average Cost of Capital (WACC) of 12%. The cash flow projections were based on management's forecasts, accounting for expected revenue growth, cost of goods sold, operating expenses, and capital expenditures.

Key Assumptions:

- » Revenue Growth: 8% CAGR over the next five years.
- » Operating Margin: 8% on average.
- » Terminal Growth Rate: 3%.
- » WACC: 12%.
- » Valuation Premise: Going Concern

DCF Valuation Summary

Based on the projected free cash flows, terminal value, and discount rate, the equity value under the DCF

Method has been estimated at **NPR 220 million**

Detailed DCF calculations have been attached as **Annexure A**.

Market Approach (Comparable Companies Method):

Under the Market Approach, the value of the Company is estimated by comparing it with similar listed or market-observable companies operating in the same or similar industry.

Based on comparable textile and manufacturing companies, an average Price Earnings multiple of 10x has been considered.

Particulars	Amount
FY 2023 Net Profit	NPR 18 million
Applicable P/E Multiple	10x
Equity Value under Market Approach	NPR 180 million

Accordingly, the equity value under the Market Approach is estimated at **NPR 180 million**

Detailed comparable company analysis have been attached as **Annexure B**

Asset Approach Method:

Under the Asset Approach, the value of the Company is estimated with reference to the fair value of its identifiable tangible assets after considering depreciation and other necessary adjustments.

Particulars	Amount
Replacement value of machinery and equipment	NPR 50 million
Less: Depreciation / condition adjustment	NPR 10 million
Adjusted value of tangible assets	NPR 40 million

Accordingly, the equity value under the Asset Approach is estimated at **NPR 40 million**

Detailed asset valuation workings should be attached as **Annexure C**.

5. Reconciliation of Valuation Approaches

Each valuation approach provides a different perspective. The Income Approach has been assigned the highest weight as the valuation is being carried out for acquisition purposes and the Company is a going concern with future earning potential.

Method	Value NPR in million	Weightage	Weighted Value NPR in million
Income Approach — DCF Method	220	60%	132
Market Approach — Comparable Companies Method	180	30%	54
Asset Approach — Adjusted Net Asset Method	40	10%	4
Total Fair Value		100%	190

Therefore, the fair value of 100% equity interest in ABC Manufacturing Company is estimated at **NPR 190 million**



6. Assumptions and Limiting Conditions

This valuation is subject to the following key assumptions and limitations:

- a) The Company will continue to operate as a going concern.
- b) The financial information and projections provided by management are accurate and complete.
- c) No independent audit or due diligence has been performed by XYZ Chartered Accountants.
- d) The valuation does not consider any undisclosed liabilities, contingent liabilities, tax disputes, legal claims, or regulatory non-compliances unless specifically provided to us.
- e) The Nepalese economy and textile industry are assumed to remain reasonably stable.
- f) Future performance may differ from projections due to changes in market, economic, regulatory, or business conditions.
- g) This report should not be considered as an audit report, fairness opinion, solvency certificate, or investment recommendation.

7. Valuation Conclusions

Based on the valuation procedures performed, information made available to us, and the assumptions and limitations stated in this report, we estimate the fair value of 100% equity interest in ABC Manufacturing Company as at January X, 202X at NPR 190 million

This value represents the weighted conclusion derived from the Income Approach, Market Approach, and Asset Approach. The Income Approach has been given the highest weight as it best reflects the future earning capacity of the Company as a going concern.:

8. Disclaimers and Disclosures

This report has been prepared exclusively for XYZ Private Limited for the purpose of assessing the potential acquisition value of ABC Manufacturing Company. It should not be circulated, quoted, reproduced, or relied upon by any third party without prior written consent of XYZ Chartered Accountants.

The information used in this valuation has been obtained from management and other sources considered reliable. However, XYZ Chartered Accountants does not provide any guarantee regarding the accuracy or completeness of such information.

The valuation conclusion is dependent on the assumptions stated in this report. Actual results may vary from projections, and such variation may be material.

9. Annexures

The following annexures should form part of the complete valuation report:

- Annexure A: Detailed DCF Valuation Working
- Annexure B: Comparable Companies Analysis
- Annexure C: Asset Valuation / Replacement Cost Working
- Annexure D: Historical Financial Statements
- Annexure E: Management Representation Letter
- Annexure F: Sources of Information

Prepared by:

Name of Professional

XYZ Chartered Accountants

Membership Number:

February X, 202X



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